To: Jonathan G. Katz, Secretary, Securities and Exchange Commission

Subject: NASD-2005-112

Re: Release No. 34-52679

Dear Sir,

I thank you for this opportunity to comment on the proposed changes to NASD Rule 3360 in order to expand the short interest reporting requirements to all OTC securities. In a nutshell, I highly recommend this proposal and its implementation as soon as possible.

I have been fortunate enough to devote the last 24 and one half years of my life to a very thorough study of the phenomenon known as naked short selling. During that timeframe I have written 2 unpublished textbooks on the subject, the most recent being an approximately 800-page analysis of naked short selling and the role of unethical DTCC participating market makers and clearing firms and their interrelationships with primarily unregulated hedge funds.

As you at the SEC have no doubt realized by now, the wording used in Reg SHO has left a glaring loophole that any DTCC participants wishing to circumvent the spirit of this new Federal Law can easily access. Although the “Forced” federally-mandated buy-ins for certain threshold securities are clearly outlined, somebody at the SEC unfortunately inserted the verbiage, “If the participant does not take action to close out the open fail to deliver position (AS MANDATED BY THIS NEW FEDERAL LAW), the participant is prohibited from making further short sales in that security without first borrowing or arranging to borrow the security”. Unfortunately, no clarification of what constitutes a legitimate reason for being unable to execute a mandated buy-in was included except that the reason cannot be of a financial nature. In other words, if you refuse to obey this new Federal Law mandating “Forced” buy-ins which is now part of the 1934 Securities Exchange Act, your punishment is nonexistent but you’re reminded to obey the law in the future. I don’t know if this was inadvertent or just more “Deterrence-SEC style”.

In a recent “self-interview” published by the DTCC, the DTCC made it crystal clear that they intend to utilize this loophole graciously provided by the SEC. In this interview, the interviewer asks the Deputy General Counsel of the DTCC the following: @ DTCC (the interviewer): “So Reg SHO doesn’t force them to close out the position, even market makers are not exempt from this requirement, but if they don’t, they are prohibited from making any additional short sales without borrowing the shares first”?

Thompson (the DTCC Deputy General Counsel): “That’s right.”

What's interesting is that in the answer to the previous question this same Deputy General Counsel states: "The "Close-out" requirement **FORCES** (emphasis added) a participant of a registered clearing agency to close out any "fail to deliver" position in a threshold security that has remained for 13 consecutive days by purchasing securities of like kind and quality". This verbiage is consistent with the exact phrasing of the law.

My question to you at the SEC is, "Which is it"? Are these DTCC participants "FORCED" to do these "Mandated" buy-ins as outlined in the text of the law or not? My second question would be can the DTCC's actions be interpreted as recommending to its participants the breaking of the new Federal Law (Reg SHO) because the punishment, irresponsibly advertised by somebody at the SEC as being nonexistent, really is nonexistent? People can and do break Federal Laws all the time. My third question is why advertise the loopholes accessible for breaking these new Federal Laws with no recourse within the text of these new Federal Laws unless, of course, somebody at the SEC's heart wasn't quite in the right place all along but wanted the SEC to be PERCEIVED anyways as acting as a shareholder advocate that is following its mission statement of providing "Investor protection and market integrity"?

I think that you at the SEC can now get a pretty good idea of why the shareholder advocacy groups are critiquing the effectiveness of the new Reg SHO "Threshold Lists". One fact that "pre-doomed" the bulk of Reg SHO's honorable intentions is the rule on the books of the DTC and the NSCC that states that mandated buy-ins need not be executed if their effect might be "Disruptive" to the markets. In layman's terms this means that mandated buy-ins in the shares of an issuer that fell victim to a "Bear raid" that resulted in its share price falling from $5 to 2-cents need not be done because these buy-ins might result in a "Market Disruption" involving the share price skyrocketing to 4-cents, an enormous 100% gain. As you at the SEC are painfully aware, Section 19 C of the '34 Exchange Act disallows the SEC from amending the rules and regulations of any "Registered Clearing Agency" like the DTCC. A quick review of some facts regarding naked short selling might help you to coordinate your battle plan against naked short selling IF THIS IS TRULY A HIGH PRIORITY OF THE SEC.

SOME FACTS RELATED TO THE NAKED SHORT SELLING OF U.S MICRO CAP SECURITIES

1) There are currently approximately 8,200 hedge funds managing approximately $1.05 trillion. About half of these fly under the regulatory radar due to some loopholes in the 1940 Investment Company Act.
2) In the post-decimalization era, market maker "Spreads" are now razor thin and many securities scholars contend that ethical market making firms cannot make an honest living in this environment. The downside of that notion is the resultant "Survival of the corruptest" form of natural selection we are now witnessing in regards to the naked short selling pandemic.
3) Unethical market makers will bend or break any rule to attract the business of these hedge funds. They have to in order to survive. The money from primarily

unregulated hedge funds drives this entire naked short selling “Industry within an industry”.

4) In-house proprietary trading activity has skyrocketed recently among market making firms.
5) Our OTC markets are trying to “Evolve” and eliminate human intermediaries (market makers) subject to human greed and in possession of a vastly superior “KAV” factor (**<u>K</u>**nowledge of, **<u>A</u>**ccess to and **<u>V</u>**isibility of the clearing and settlement system run by the DTCC) and replace them with unbiased computers (ECNs) to match up buyers and sellers. The current Wall Street power and influence structure will not allow this evolution to occur.
6) Unethical hedge funds will feed their massive order and commission flow generating abilities to any market making and clearing firm that prove to be the most “Accommodative” to these behemoths and their desires. They expect rules to be bent and broken on their behalf. Access to illegally working out of a MM’s “in-house proprietary account” is especially deserving of certain “Concessions” as we have seen in several recent cases involving certain hedge funds and certain market makers.
7) Hedge fund managers are under a lot of pressure to perform or their wealthy clients will move their money elsewhere. These clients expect their hedge fund managers to seek out “Accommodative” market making and clearing firms even if there is criminal risk incurred by the hedge fund manager.
8) Bona fide market makers are legally allowed to naked short sell securities but only while acting in the capacity of a “Bona fide” market maker.
9) A bona fide market maker is expected to naked short sell nonexistent “shares” at the $5 level when an imbalance of buy orders over sell orders is present at that level and he has no inventory at the time.
10) Should the share price drop to perhaps $4.80 then a bona fide market maker uses the proceeds from the sale of the nonexistent shares he legally naked short sold at $5 to buy back these shares and pocket this 20-cent “Spread”. A bona fide MM is happy making “The spread”.
11) A bona fide market maker injects liquidity by buying shares when sell orders outnumber buy orders **with the same zeal** that he shows while selling shares when buy orders outnumber sell orders. The problem is that buying shares consumes money while selling shares, even if you don’t own nor intend to ever purchase shares, makes money because of how the DTCC is “Wired”.
12) A bona fide market maker does not direct or restrict share price movement; he buffers the intensity of the swings in share price. The two main roles for short selling in general are to inject liquidity and to create “Pricing efficiency”. To create “Pricing efficiency” all negative votes (short sales) as well as positive votes (buy orders) need to be tallied as long as the short sales were preceded by a legitimate “borrow” i.e. not a “Borrow” from a “Self-replenishing” source like the DTCC’s “Automated Stock Borrow Program” or “SBP”. Legal short selling is a very good thing that is crucial to the markets. Abusive naked short selling is a form of market manipulation which is a 10b-5 securities fraud usually involving criminal enterprises.

13) A bona fide MM, when faced with a large amount of buy-side activity, will allow the share price to find an equilibrium level above the current price after selling a **MODERATE** amount of shares at the lower price.
14) A bona fide MM would rather sell nonexistent shares at a higher level than at a lower level UNLESS HIS CURRENT NAKED SHORT POSITION HAS GOTTEN OUT OF HAND TO THE POINT THAT COLLATERALIZING AN ASTRONOMICALLY HIGH NAKED SHORT POSITION AT HIGHER LEVELS MIGHT BE COST PROHIBITIVE. SHOULD THIS SITUATION PRESENT ITSELF THEN FRAUDULENT NAKED SHORT SELLING IS OFTEN SEEN AS THE ONLY ESCAPE ROUTE AND A “BLANKET” OF FRAUDULENT NAKED SHORT SELLING IS OFTEN PROVIDED BY THE TROUBLED MM AND ANY WILLING CO-CONSPIRATORS THAT HE CAN “RECRUIT”.
15) Bona fide market makers don’t get caught in this trap as they are more than willing to increase the price level of their offers if the buy-side pressure remains. This is referred to as “Averaging up”. Not so bona fide market makers don’t have this luxury if they were guilty of greedily selling nonexistent shares in a non-stop fashion just to get their hands on the buyer’s money before a competing MM was able to.
16) The ability TO APPEAR to be legally naked short selling securities while acting in a bona fide market making capacity is something the unethical hedge funds desire very badly but cannot legally attain.
17) There are many unethical market makers that have been so decimated by decimalization that they allow unethical hedge funds space under their “Umbrella of immunity” from borrowing before short selling which is supposed to be only accorded to bona fide MMs acting in a bona fide market making capacity at the time. The rental fees for this “Space” is paid in fees and commissions via order flow.
18) There are very few regulatory policemen monitoring market making activity in regards to whether naked short selling is truly “bona fide” or not.
19) When presented with trading evidence in a court of law, it would be extremely difficult for an unethical MM to claim that he was indeed acting in a bona fide market making capacity while constantly naked short selling into buy orders that dwarfed sell orders as a stock’s share price plummets from $5 to 2-cents. When buy orders overwhelm sell orders for prolonged periods of time share prices go up not down. Naked short selling by theoretically bona fide MMs is only legal when buy orders overwhelm sell orders.
20) The supporting bids of unethical MMs taking part in “Predatory trading strategies” are conspicuously absent as share prices fall despite their having the money from investors buying at higher levels in their coffers. THE SEC, NASD, AND DTCC CAN EASILY DETECT THESE PREDATORY TRADING STRATEGIES BY UNETHICAL MMs WHILE STUDYING TRADING DATA. THE EVIDENCE JUMPS OFF THE PAGE AT YOU.
21) The “Continuous Net Settlement” system (CNS) in use at the DTCC “Nets out” on a daily basis buy and sell orders which is extremely efficient BUT has a “Masking” effect on delivery failures which is an unwanted side-effect UNLESS

YOU WANT TO HIDE THE EXISTENCE OF A PLETHORA OF UNDADDRESSED DELIVERY FAILURES. THEN IT'S JUST WHAT THE DR. ORDERED. DR. LESLIE BONI RECENTLY PUBLISHED AN EXCELLENT RESEARCH PAPER OUTLINING THE "PERVASIVENESS" OF DELIVERY FAILURES RESULTING FROM NOT SO BONA FIDE MARKET MAKING ACTIVITY.

22) At the DTCC, it is extremely easy for fraudsters to illegally sell nonexistent shares and actually get their hands on the proceeds **without ever covering**. **PARDON US IF WE INVESTORS FIND THIS CONCEPT TO BE NOT ONLY HEINOUS BUT UNCONSCIONABLE.** All these fraudsters need to do is to collateralize the naked short position in a "Marked to market" manner on a daily basis such that the depressant effect on the share price from yet further naked short selling allows the proceeds from previous naked short sales to fall into the lap of the perpetrators of these frauds. The key is to never stop naked short selling which might have the untoward effect of allowing the share price to increase to find its own unmanipulated equilibrium level. The current clearance and settlement system in use at the DTCC allows naked short positions to be run up so rapidly that if the victimized issuer fails to die on cue then the perpetrators of this fraud cannot only not cover these positions without financial collapse but they can't even stop the daily onslaught without risking the share price going up. The allure of free investor money is so overwhelming that prudent short selling practices fall by the wayside.

23) For the most part, naked short sellers don't ever cover; they don't have to. They can always fall back on their ace in the hole as a "Participant" of the DTCC by refusing to execute even buy-ins mandated by the old NASD Rule 11830 as well as the new Reg SHO because of possible market "Disruptions". The financial critical mass of these hedge funds and co-conspiring Wall Street behemoths will outmuscle even the most formidable preyed upon targets. If they meet resistance then there are available "Internet bashers" to employ and financial "Journalists" for hire to produce "Hatchet jobs" to propagate any negative stories whether of merit or not. First Amendment freedom of speech issues as well as Internet anonymity are utilized to delivery any unfavorable opinions.

24) The key to naked short selling fraudsters is to get these trades involving the sale of nonexistent shares to "Clear" even though "Settlement" (Which involves the "delivery" of that which was thought to be being bought i.e. genuine "shares" or "packages of rights" attached to a specific U.S. Corporation) may never occur. The "Automated Stock Borrow Program" at the DTCC allows shares held in "Street name" at the DTCC to be borrowed from an anonymous "Lending Pool" of shares. This allows the firm of the buyer of these nonexistent shares to receive delivery of "something" that at least resembles a legitimate share at first glance. The problem is that the buying firm is allowed to immediately place these "Shares or share facsimiles" right back into this same anonymous "Lending pool" of shares AS IF THEY NEVER LEFT IN THE FIRST PLACE. THE BUYING FIRM IS THEN HANDSOMELY REWARDED BY THE DTCC WITH THE CASH EQUIVALENT OF THE SHARES DEPOSITED INTO THE POOL AND CHOSEN TO CLEAR THE NEXT FAILED DELIVERY. THIS WONDERFUL

ABILITY TO CONVERT A CLIENT'S PURCHASES OF REAL SHARES OR "PSEUDOSHARES" INTO CASH FOR THE USE OF THE BROKER/DEALER PROVIDES PLENTY OF INCENTIVE TO KEEP THE "LENDING POOL" FULL TO CAPACITY. THE SELF-REPLENISHING ASPECT ALSO HELPS KEEP IT FULL TO ADDRESS AS MANY "FAILED DELIVERIES" AS THE SYSTEM WILL GENERATE WHICH IS AN INFINITE AMOUNT IF NO REGULATOR MONITORS FOR THE APPROPRIATENESS OF THE USE OF THE "BONA FIDE" MM EXEMPTION FROM BORROWING BEFORE SHORT SELLING.

25) The "Counterfeit Electronic Book Entries" ("CEBEs"-electronic book entries at the DTCC without a certificated share in a DTCC vault to justify its existence) that result from the lack of buying-in these failed deliveries then appear on investors' monthly statements as readily-sellable "Pseudo-shares" despite the fact that there is no paper certificate in a DTCC vault to justify its existence. Keep in mind that the DTCC at all times has full visibility of the number of "CEBEs" as well as genuine shares held in their vaults.

26) The "Supply" variable that interacts with the "Demand" variable to determine share price then becomes the arithmetic sum of all genuine paper-backed electronic book entries at the DTCC plus the number of "Counterfeit Electronic Book Entries". This greatly enhanced "Supply of readily-sellable shares" then interacts with a greatly diminished "Effective Demand" for shares due to buy orders for shares being effectively neutralized by the sale of nonexistent shares into these buy orders resulting in the typical precipitous drop in the share price of the preyed upon U.S. Corporation. This allows the unknowing investors' funds to flow into the lap of those that sold nonexistent "Entities" but still refuse to cover.

27) The 2 main repositories for these unaddressed delivery failures are the DTCC "D" sub accounts and the "Non-CNS delivery arrangements" shunted to "Ex-clearing" hiding places. The "Ex-clearing" hiding places involve DTCC participants "Pairing off" and allegedly informally agreeing to not buy-in each other's failed deliveries. B/d "A" agrees to not demand delivery of the $5 billion worth of securities owed to it by B/d "B" in exchange for B/d "B" doing likewise with the $5 billion worth of failed deliveries owed to it. The DTCC holds that these are "Contractual" arrangements between its participants and that it has no business in monitoring. Victimized issuers and investors might beg to differ as any "Self-Regulatory Organization" might be expected to do a little "Self-regulating" of the activity of its participants which unfortunately at the DTCC own the DTCC. The DTCC management aggressively regulating the behavior of those that sign their paychecks is a bit of a design flaw creating yet another conflict of interest.

28) Section 17 A of the '34 Act set up the DTC which later merged with the NSCC to form the DTCC. It mandated "The prompt and accurate clearance **AND SETTLEMENT** of transactions involving the transference of ownership". Even in the Reg SHO environment the trades done by naked short selling fraudsters still aren't "settling". "Settlement" mandates "Good form delivery" of that which was intended to be purchased by the buyer-a "Package of rights" attached to a specific U.S. corporation domiciled in a specific U.S. state. You cannot have "Good form

delivery" if that which is being "Delivered" comes from a self-replenishing "Lending pool" of shares provided by the DTCC's "Automated Stock Borrow Program" (the SBP) especially when that which is delivered to the new buyers broker/dealer can immediately be replaced right back into the same "Lending pool" from whence it just came as if it never left at all. In order for a system like this to have one scintilla of integrity, the "Shares/pseudo-shares" delivered to the new buyer's brokerage firm would be sequestered or escrowed off to the side and not allowed to be replaced into the "Lending pool" UNTIL the original loan was repaid.

29) What our current system does is to allow trades to "Clear" at warp speed without legally "Settling". Dr. Boni's research clearly showed the "Pervasiveness" and extreme age of the failed deliveries stacking up at the DTCC. This vastly dilutes the "Readily-sellable" share structure of targeted corporations causing their share price to plummet which allows the proceeds from the sale of bogus shares to actually flow into the laps of the fraudsters despite their having absolutely no intent of ever buying or replacing that which they have already sold. Recall that all the fraudsters have to do is to collateralize this ever-diminishing debt on a daily "Market-to-market" basis.

30) If the SEC is sincere about addressing this problem, I would suggest they start with legislation to rescind Section 19 C of the '34 Act which currently forbids the SEC from altering the rules and regulations of the DTCC. The combined 800-pages of rules and regulations of the DTC and NSCC, in my humble opinion, is the most conflict of interest-ridden set of rules on the planet. The lack of necessity to execute buy-ins mandated by the old NASD Rule 11830 and the new Federally mandated Reg SHO threshold securities buy-ins due to the pretense of avoiding "Market disruptions" is in the opinion of most securities scholars nothing short of criminal as by definition there has to be a "Market disruption" involved when leveling the playing field of a victimized issuer that has lost 99% of its market capitalization due to abusive naked short selling by DTCC participants hiding behind their rulebook that is untouchable by the SEC.

In summary, this NASD Rule 3360 proposed rule change represents a step in the right direction especially if made a part of a more comprehensive plan that addresses the loopholes inadvertently left in Reg SHO. The systemic risk levels currently being incurred by all U.S. citizens due to the greed of abusive DTCC participants and co-conspiring hedge funds and naked short selling cartels is intolerable. The inability for Reg SHO to address the preexisting delivery failure problem hints at just how serious and pandemic this problem is. The voluntary "Grandfathering in" of previous acts of securities fraud sets a very scary precedent. As I see it, you at the SEC have run out of comfortable middle ground to occupy in this dilemma. You now see the absolute numbers of delivery failures of a given issuer on a daily basis. You either have to warn prospective buyers, as per the '33 "Disclosure Act", of these levels of "Readily sellable share facsimiles" (unaddressed delivery failures) being held at the DTCC or in "Ex-clearing arrangements" **IN ALL OTC SECURITIES** or order their being bought-in. There is no third choice. These prospective investors need to be warned that they're buying shares of corporations with astronomic levels of unaddressed delivery failures which have basically pre-ordained their investment to an early death as statistics will readily bear out. The 1933 Securities Act mandates that investors be made aware of all information pertinent to the "Character" of the securities being sold in our markets. In a prospectus you at the SEC appropriately make a new issuer reveal every possible tiny grain of sand of risk to the investing public yet you at the SEC, the NASD, and the DTCC possess information about a gigantic "Boulder of risk" present in investing in especially nonreporting issuers with a plethora of unaddressed delivery failures, yet you keep silent. Note that the Reg SHO "Threshold lists" don't even discriminate between a corporation with a 0.6% delivery failure rate from a corporation with a 66% delivery failure rate. There really is no middle ground left on this landscape strewn with corporate carcasses for the SEC to safely stand on any longer. Either tell us about these positions as the amended 3360 would partially address or buy-in the failed deliveries. If mandated buy-ins result in the weeding out of the most abusive market making and clearing firms then so be it. This might allow our markets to evolve into more efficient computerized markets not subject to human greed and massive conflicts of interest between DTCC participants and the investors they owe a fiduciary duty of care to. Thank you for your interest in this subject.

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