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May 6, 2009



The Honorable Mary L.Shapiro
Chairman
U.S. Securities & Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

# *Proposed Recommendations for Resolution for the Clearing and Settlement of Short Sales*

Dear Chairman Shapiro:

My name is Salli Marinov and I am one of many transfer agencies that have grave concerns regarding the issue of naked short selling and short selling, in general. I am also on the National Board of the Securities Transfer Association. Currently, there is a proposed rule released for comment (SEC Release No. 34-59748, File No. S7-08-09, Amendments to Regulation SHO, Comments due June 19, 2009) that is concerned with two approaches in the trading of short sales, namely the uptick rule and the concept of the circuit breaker. I, personally, am in favor of this timely address for both of these issues but what is of more concern for many transfer agencies is the clearing and settlement portion for which there is not yet any focused attention. Resolving only these front-end portions of the problem does not provide a "fix" for the entire situation, as there will be no built-in checks and balances. On behalf of the approximate 16,000 domestic and foreign publicly-traded issuers for which we provide services, the Securities Transfer Association ("STA") would like the opportunity to comment, and will provide comment, on any Proposed Rule released for comment that deals specifically with the clearing and settlement problems associated with Regulation SHO. I am writing this letter in the hope of respectfully request that the Securities and Exchange Commission publish and release for comment a Proposed Rule that deals specifically with a resolution for the clearing and settlement of short sales.

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The process of naked or hypothecated short sales is a many-faceted system unto itself. From order placement, to coding on the order, to actions at market, to hypothecating policies, to software systems and attempts to settle transactions without knowledge of share status, to DTC and NSCC fighting to maintain the status quo as if nothing was wrong, to entitled settlement, to the expulsion of transfer agents who could offer a temporary fix, this problem has grown into what appears to be an impossibly tangled and unsolvable puzzle. Each part must be fixed for total resolution of the problem. As a transfer agent I am not an entity that deals directly with trading practices and cannot offer comment on the current Proposed Rule. But, again, I can offer suggestions and, hopefully, recommendations for clearing and settlement.

## Background

From 1933 to 1968 approximately, settlement of securities transactions was accomplished through physical delivery of stock certificates among brokers and each broker had his own securities depository. Brokers settled customer accounts only with registered securities and only if the brokers had physical possession. "Security" was still defined by Securities Acts and SEC Rule definitions, not according to UCC definitions.

However, trade volume rose tremendously during the 1960's and physical delivery settlement became untenable. Due to the problems experienced with overwhelming paperwork and the financial crisis of 1967-1970, 115 firms left the NYSE either by merger, resignation or liquidation (1).

This paperwork nightmare brought many structural changes to the industry. NYSE created the Central Certificate Service, trades started clearing and settlement through a central clearing agency and book-entry processing started to replace certificated processing. Without a certificate to provide evidence of ownership, however, the soundness of broker and customer accounts came into question. Under the book-entry system, the soundness of the entire market completely rests on the integrity of book-entry movements and on the definition of "security" in customer accounts.

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## Overview of Current Clearing and Settlement Process and the Role (or lack thereof) of Transfer Agent

As a corporation enters the public market, they are required to designate a transfer agent. Transfer agents have historically been tasked as the keeper of the control book and the keeper of shareholder records for these public corporations. As such, only the transfer agents have accurate and legitimate total share positions for each registered shareholder, including the registered shareholder, CEDE & Co., the nominee name for the Depository Trust and Clearing Corporation. CEDE shares encompass all those shares traded in "street name" on a daily basis and, once shares are included within CEDE's daily balance, are considered to be a fungible mass without clear definition. This lack of clear definition did not present a problem with delivery as long as the issue was 1) a certificated issue, and/or 2) the shares were able to ultimately be presented at the transfer agent for validation of share balance.

Since the advent of electronic book-entry shares, however, the delivery of these fungible mass shares is no longer clearly defined. This problem is exacerbated by the inability of the shares to be presented at the transfer agent as a temporary "fix" for verification of the true share position. In fact, the Depository Trust and Clearing Corporation does not present these transactions to the transfer agent for verification at all.

In addition, the SEC re-defined "security" from the federal securities laws to "security" as defined under individual state's UCC and has issued an authorization to market participants that "...a securities broker-dealer may credit a customer's account with a security even though that security has not yet been delivered to the broker-dealer's account by NSCC. In that event, the customer receives what is defined under the Uniform Commercial Code as a "securities entitlement"". Therefore, there is no accountability for CEDE's true share position specifically. This gives free rein for DTC and their participants to hide from both the issuer and the transfer agent what is and is not available for trading.

Currently when a short sell transaction occurs, the order must note whether the holder is "long" the shares or short, and, if short, where the shares may come from (borrowed) to satisfy the position at settlement. If the shares are to be borrowed, the order is coded as "entitled" to shares, instead of long the shares. Once an order is coded as "entitled" it is

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treated as if the shares will actually be delivered and T+3 settlement is therefore not delayed. But there is little accurate tracking for when the shares are actually delivered and the position is changed from "entitled" to long the shares. It can remain as a fail to deliver indefinitely, interest can continue to accrue to the lender (DTC and its participant) but the borrower is already settled. The borrower can then turn around and sell what is not his to begin with. Brokers are often paid on these "settled" transactions that were initially coded as "entitled" whether or not the shares were ever truly delivered.

Part of the problem arose because of the particular software that DTCC wrote with the National Settlement and Clearing Corporation to accommodate the processing of transactions. There were a finite number of computer-generated response boxes to complete, and not enough room for the hypothecation specifics to be listed and followed. There was no defined or built-in transparency and no tracking. And there have been no enhancements to the software to correct these glaring problems.

From 2003 to 2006 there were 14 lawsuits against DTCC for naked short selling. DTCC was never served on four of them and the suits subsequently dismissed. One was dismissed against Directors of DTCC, with prejudice. DTCC filed successful motions to dismiss on four of them and one was dismissed voluntarily by the plaintiff. These actions reflect good defense moves on the part of DTCC but not necessarily the facts of the situation. As of January 2006, three were still pending. Despite DTCC's continued disclaimers that they are doing nothing wrong, what are they doing to make it right? With the filing of so many lawsuits, there is definitely the appearance of a fox in the henhouse. There is also an elephant in the living room that is being ignored and walked around with the pretense that it is not there. Both the fox and the elephant are DTCC with their affiliate NSCC. The transfer agents are not allowed to offer resolution for their individual issuers and there is no mandated accountability from the SEC to provide transparency and tracking within the software available for use between the brokers, clearing firms, NSCC and DTCC. And, to state the obvious once again, the individual ***TRANSFER AGENTS ARE THE ONLY ENTITIES WHO HAVE AN ACCURATE REFLECTION OF SHARES PER REGISTERED POSITION ON ANY GIVEN DAY.*** But transfer agents are ignored in the current clearing and settlement process.

Our group is not necessarily suggesting a rescission of what's become known as the "ex-clearing" rule, SEC Release No. 34-50758, File No. S7-24-04. If a resolution can be reached in which there is an accurate transparency-based, tracking system-type software

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created to correctly follow the entire flow of any trade that enters the system, with stated regulation and penalties incurred for non-adherence, no rescission may be needed. But the transfer agent's position balances should never be kept as a complete unknown, as they are now.

## Proposed Recommendations for Resolution of Clearing and Settlement of Short Sales

As a transfer agent, First American Stock Transfer, Inc. accepts the proposed recommendations previously presented in April, 2008 by the National Investor Protection Coalition (NIPC) with a few additions. The complete set of recommendations I am offering (including those of NIPC) are the following:

1. The UCC rule (definition of "security) should be abolished and brought back to the federal level with a new definition of security promulgated by federal securities laws. Federal securities laws that define a security should also include the general concept of entitlements without allowing entitlements to be treated as already-settled trades.

2. All sale transactions should be coded as long in the account, or borrowed. If borrowed, it should be noted who is hypothecating the shares and who is entitled to them and when the expected time of delivery will be, if not within T+3. (Transparency)

3. Each entity in the process should have computer-generated identification or "cookie", an individually assigned number attached to their trade order/request/confirmation, etc. that is placed in the software system. (Tracking)

4. There should continue to be settlement at T+3, **or less**. However, if shares are hypothecated, there should be an additional time limit for the delivery to take place that goes beyond the T+3, but not longer than T+7. This time frame can be coded as "conditional T+3". If, after T+7 there is no delivery, it is considered a failed trade, and broken. All funds are re-credited to the customer account at that time. (Tracking and Transparency)

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5. When shares are delivered, both the lender and the receiver should note the delivery in the system within 24 hours or less. (Tracking)

6. The replacement securities must have the same aggregate value as the value of the hypothecated securities.(Transparency)

7. No replacement securities credited to customers when customer securities are hypothecated may be guaranteed or issued by market participants, nor have counterparty relationships created with them.(Transparency)

8. Only NMS securities that fulfill the registration requirements of Section 5 of the Securities Act of 1933 can be credited as replacement securities to customer accounts when customer excess margin securities are hypothecated. Cash may be used as well. (Transparency)

9. Brokers must debit the securities they hypothecate from customer accounts and when excess margin securities are hypothecated, they must satisfy registration requirements, aggregate value requirements and have no guarantees attached or have created counterparty relationships.(Tracking and Transparency)

10. Customers become the beneficial owners of the securities provided in lieu of the hypothecated securities, and maintain full control over them including the ability to sell them at any time.(Transparency)

11. Prescribe penalties to those violating the rule.(Accountability)

## Conclusion

Based on the foregoing, many transfer agents believe there is a resolution that can be reached for the clearing and settlement of these issues. To correct the clearing and settlement portion at the same time as the problematic trading actions are addressed lends the possibility for checks and balances to be built into the entire process. First American Stock Transfer, Inc. respectfully requests the Securities and Exchange Commission

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to release for comment a proposed rule that deals with the clearing and settlement short sale concepts offered herein.

In this regard, I would be happy to answer any questions, which you might have, and look forward to the opportunity to meet in person, if requested, to more fully explore these recommendations.

Very truly yours,

*Salli Marinov*
Salli Marinov
President/CEO

Cc: SEC Associate Director James Brigagliano
FINRA Chairman Richard Ketchum
United States Senator John McCain
United Sates Senator Edward E. Kaufman
United States Senator Johnny Isakson
United States Senator Jon Tester
United States Senator Saxby B. Chambliss
United States Senator Carl M. Levin
United States Senator Jon Kyl
United States Senator Arlen Specter