



This proposed rule

4330(a), <http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p120691.pdf> requires firms to obtain a written authorization from customers before their margin securities may be loaned out. However after years of debate about short selling and stock loan practices surely the disclosure could and should cover the most opaque parts of this transaction. These include the fact that only the broker -dealer will make money on this transaction and that the securities most likely will be used for short selling. Thus the customer who pays margin interest receives no compensation and his own securities are used to short his own stock. While this has been common practice for many years it can easily be included in the required disclosure. While legitimate debate about short selling continues there is no debate that retail customers receive little benefit when their securities are used and are not likely to understand they are conspiring against their own position. We suggest therefore that the broker explain the rebate he receives and the fact that the resulting short sale may be against their own interest and perhaps that other more powerful customers may indeed participate in these stock loan profits.

The following more colorfully describes the arguably inherent unfairness of this limited disclosure and suggests an appropriate disclosure at the end. We can substitute Dendreon as the real world example of the hypothetical Acme Pharmaceutical. While the language here may be exaggerated its message is not.;

WALL STREET VERSUS MAIN STREET AND THE USE OF MARGIN ACCOUNTS by Dr. Jim Decosta

Let's assume "Buyer Bob B." has \$10,000 to invest and he wants to buy shares of Acme Pharmaceutical which has a new cancer cure. Bob is an immunologist and very familiar with the efficacy of Acme's new breakthrough drug. Bob places an order for \$10,000 worth of Acme and his broker informs him that he could actually buy \$20,000 worth of Acme if he would just open up a margin account. Bob may not be able to afford to lose \$20,000 half of which is borrowed but knowing of the potential for the new drug he takes the bait and opens up a margin a/c and buys \$20,000 worth of Acme. Bob can **afford** to buy "X" amount of Acme but he ends up buying "2X" worth but it was his choice. After all, to an immunologist like Bob Acme's chances for an FDA approval is a no-brainer.

Bob's brokerage firm's clearing firm earns a fee for the "banking" business it provided to Bob and the full "2X" amount of shares serves as the collateral for that \$10,000 loan. Bob's brokerage firm incurs veritably no risk for default on this loan with 200% collateral because they can easily sell these shares out from underneath Bob should the price drop. Let's assume that the shares that Bob bought were short sold from a short seller. This "2X" amount of shares were originally bought by an investor across town named "Buyer Bob A." They too were bought in a margin a/c; that's why they were available for lending to the short seller.

After processing Bob B.'s \$20,000 purchase order his broker now becomes the "legal owner" of that particular parcel of 2X amount of shares unknowingly "co-beneficially owned" by Bob A. and Bob B. Being the new "legal owner" of that 2X parcel of Acme shares Bob B.'s broker has all of the right in the world to rent them to yet another short seller who then sells them to yet another Bob, "Buyer Bob C." There are now 3 "co-beneficial owners" of that one parcel of impossible to identify shares. The most recent purchaser is referred to as the "legal owner" and all previous purchasers of that same parcel of shares are referred to as "security entitlement holders". This parcel of shares is impossible to identify because of the NSCC's insistence on holding "street name" shares in an "anonymously pooled" format and because of the circa 1970 "dematerialization" of tough to counterfeit paper-certificated shares into easy to counterfeit electronic book entry shares.

All "security entitlement holders" are allowed by UCC Article 8 to sell that which they purchased at any time they so choose. After a year or so let's assume that through the magic of theoretically "legal" short selling there are now 11 "co-beneficial owners" and one "legal owner" of that one impossible to identify parcel of Acme shares. Keep in mind that this is just one of many, many "daisy chains" of bogus Acme "shares" possible.

Picture Acme Pharmaceutical as a small tree attempting to grow into a big Pharmaceutical company via the introduction of their new breakthrough cancer cure. Every single time a short sale of Acme shares occurred a readily sellable unregistered share price depressing "security entitlement" was essentially "issued". Due to their being treated as being readily sellable they add to the "supply" or "float" of Acme shares which must be treated as being readily sellable. Each "borrow" associated with each short sale damaged Acme's share price similar to an ax chopping away at the young "Acme tree's" trunk.

As Acme's share price dropped from all of this wonderful "liquidity" being injected by these 12 different short sellers the 12 purchasers of the very same parcel of Acme shares through their margin accounts started to get margin calls. Since they already bought 2 times as much Acme as they could afford they were not able to meet these margin calls with cash. Therefore their brokers had to sell some of their Acme shares to meet these margin calls. This put yet further pressure on Acme's share price which resulted in yet more margin calls which in turn put yet further pressure on Acme's share price ad infinitum. Acme's share price is now into what is referred to as a self-sustaining "death spiral".

A self-propelling negative feedback loop has been established and Acme's share price went to zero as they lost any ability to raise money to advance any further through the lengthy and expensive FDA approval process. Acme had become an "easy prey" due to the nature of the business they were in, the nature of margin accounts and the DTCC's refusal to bring transparency to shares being held in "street name". Perhaps none of those 12 investors would have invested in Acme shares if they had visibility of the immense number of share price depressing "security entitlements" poisoning the share structure of Acme.

During all of this "liquidity injecting" short selling the Wall Street "securities intermediaries" made an absolute fortune. The margin a/c hosts were making banking fees right and left, the lending agents were making lending fees, the prime brokers were going to town, the executing brokers were going to town and the short selling hedge fund manager and his investors absolutely cleaned up while raking in all of the money the 12 investors lost. In fact, 12 different brokerage firms were earning rental fees while renting out the very same parcel of impossible to identify shares in 12 different directions **simultaneously**.

In slow motion what just happened here. An investor unaware of how margin accounts and short selling "DTCC style" operates got talked into buying twice the amount of Acme shares that he could afford; shame on him. His margin a/c "host" took the shares purchased, both the "X" amount of shares that the investor could afford and the "X" amount of shares that he couldn't afford and rented both parcels to a short seller whose goal it was to bankrupt Acme. In order to effect that goal the short seller needs shares to borrow and the brokerage firms earning commissions from the sale and banking income from the loan were more than happy to earn rental income from those trying to bankrupt the invested in company. One might ask what happened to the '34 Exchange Act's forbidding of **conflicts of interest** between brokerage firms and their commission paying clients.

This loan to short sellers started a "daisy chain" involving an inherent "counterfeiting/replicating" phenomenon associated with how our DTCC-administered clearance and settlement system is "rigged" in favor of the Wall Street "securities intermediaries" that own it over the Main Street investors in the Acme's of the world. It wouldn't take two seconds to put an identifier onto parcels of shares to block this "counterfeiting/replicating" process but those Wall Street insiders in favor of the corrupt status quo claim that it would be too expensive, it would decrease "market efficiency", the technology is not there yet, pricing efficiency would be lost, etc.

At the end of the day we have witnessed a very predictable "transfer of wealth" from Main Street to Wall Street because the NSCC insists on holding "street name" securities in an "anonymously pooled" format enabling this "counterfeiting/replicating" phenomenon to occur and be abused. Even though these are theoretically "borrows" occurring in short sales the key to this fraud is to craftily transfer "legal ownership" to the new purchasers of these "borrowed" shares. Why? Because nobody can stop the new "legal owner" of shares to rent them out to anybody he so chooses. But shouldn't the

previous purchaser of the borrowed shares be identified and told that he lost his “legal ownership” and therefore can no longer sell that which he purchased? That’s the trick; you can’t identify the original purchaser of those shares when shares are held in an “anonymously pooled” format and if you can’t identify him you can’t inform him that he lost his ability to sell that which he purchased. Besides, not being able to sell that which one purchased wouldn’t go over too well with him anyways and nobody would opt to use margin accounts. All of that **extra** banking and rental income would be lost. Thus you can see the need to characterize what is clearly a “sale” as a “borrow”.

The key to this totally corrupt concept of holding shares in an “anonymously pooled” format is firstly the inability to keep the original purchaser of a specific parcel of shares from reselling that which he purchased after his shares were loaned out from underneath him and secondly you can’t **prove** that 12 investors bought and now “co-beneficially own” the very **same** parcel of shares and thirdly you can’t **prove** that 12 brokerage firms are earning rental proceeds from the simultaneous renting out of the very **same** parcel of shares in 12 different directions. Pretty slick, huh?

The victims of these thefts on Main Street refer to this phenomenon as the “counterfeiting of securities” that needs to be done away with. Technically what is being “counterfeited” is not a “share” of a corporation as there are a fixed amount of those “outstanding” at any given time and this number doesn’t get altered during abusive short selling. What are being “counterfeited” are the “units” on Wall Street that contribute to the “supply” of that which must be treated as being readily sellable. These “units” include legitimate registered shares and the unregistered “security entitlements” issued during each otherwise legal “pre-borrow”, each and every NSCC SBP “borrow” and each failure to deliver that is yet to be bought-in.

Abusive Wall Street insiders will argue that there is no such thing as “phantom shares” being created during short selling as the number of “shares outstanding” does not increase. What they (not so mysteriously) forget to mention is that the number of “shares outstanding” is not the only component of the “supply” variable that interacts with the “demand” variable to determine share prices. The other component is the number of “security entitlements” that are issued. I think that you in Congress can appreciate the reason why the DTCC management needs to make these intentional misrepresentations i.e. the aforementioned “iceberg” that nobody except for U.S. "long" investors and U.S. corporations are in a hurry to address.

The beneficiaries of these thefts inhabiting Wall Street refer to this blatant “counterfeiting” process as the “injection of liquidity” and the enhancement of “market and pricing efficiencies” which they lobby aggressively to maintain as the status quo. Although mere “security entitlements” are not technically “shares” of a corporation they are indeed “securities” as any “evidence of indebtedness” qualifies as a “security”. Thus the “counterfeiting” of securities phraseology is quite accurate but technically perhaps **“the abusive inducing of the issuance of readily sellable share price depressing “security entitlements” with the intent to defraud the purchasers of nonexistent shares for one’s own financial gain”** would be more accurate.

Theoretically “anonymous pooling” is used to enhance “market efficiency” and “streamline” the clearance and settlement process. In the case of abusive short selling, however, what is really being “streamlined” is the flow of investor funds into the wallets of abusive short sellers and those that act as “securities intermediaries” in the short selling process. At the recent SEC “roundtable” we saw the Wall Street insiders aggressively lobby to maintain the corrupt “status quo” and all of the standard malarkey about the theoretical benefits of short selling were cited.

In the example cited above the Main Streeters using margin accounts lost not only that which they could afford to lose but twice that amount and those extra shares they purchased “on credit” actually provided the leverage to augment, via the triggering of unable to meet margin calls, the already inherent “counterfeiting/replicating” phenomenon associated with otherwise legal short selling. Margin accounts clearly need a “black box warning” that unsophisticated investors can read and understand. Encouraging U.S. “long” investors to “double down” on their investments only to use the shares bought on credit as leverage against the entire amount of the “double down” is a very dirty trick especially when all of the “securities intermediaries” on Wall Street are heavily financially incentivized to assist in the defrauding process.

Didn’t we just witness the exact same modus operandi in the housing industry wherein Main Streeters were encouraged by Wall Street “banksters” to “leverage up” and get in over their heads so that the “banksters” could make tons of money in loan processing fees, commissions, banking income, rental income, etc. Doesn’t that seem like a bit of a dirty trick to facilitate the “doubling down” by client’s owed a fiduciary duty of care only to take that double amount of shares that were purchased to facilitate the destruction of the investment made all while raking in income that was otherwise unattainable if the client did not double down?

Can you see in the above example how the more an investor knew about the company he was investing in the more he would be tempted to buy on margin which paradoxically made it more probable that those that knew absolutely nothing about this new medical breakthrough would end up predictably siphoning his investment funds into their wallet? Abusive short sellers refer to this as the enhanced “market efficiency” they wouldn’t want any new regulations to do away with.

Should margin accounts have a “black box warning” similar to this? **Warning:** *There is a significant chance that the shares you are purchasing partially on credit will act as a “seed” to propagate the formation of an unlimited amount of readily sellable share price depressing “security entitlements” that can be used to loan to short sellers to aid them in their attempts to bring down the corporation you chose not only to invest in but to actually double down on your investment bet.*

The shares you purchased plus all of their “offspring” will be used to predictably manipulate the share price of the “invested in company” downwards. This may likely result in you receiving “margin calls” which if you cannot answer with cash will result in a portion of your shares and those of other margin a/c holders to be forcefully sold which

will exacerbate this downward movement in share prices which may lead to yet more margin calls.

This is due to how shares held in “street name” are currently held in an impossible to identify “anonymously pooled” format that provides enough opacity to allow abusive DTCC “participants” and their hedge fund “guests” to systematically use the shares you purchased in your margin a/c to augment your own brokerage firm’s well-compensated efforts to route your investment funds into their wallets aided by an inherent “counterfeiting/replicating” phenomenon naturally present in any system using “anonymous pooling”. The brokerage firm you paid a commission to and are paying banking fees and interest to will be handsomely rewarded via banking fees, commissions, rental income, enhanced order flow from the hedge funds they are aiding and abetting, etc. for their efforts rendered on behalf of the financial interests of those trying to bankrupt your invested in corporation.

Peter J.Chepuvavage
Executive Director,CFAW
General Counsel
Plexus Consulting LLC
1620 I St. N.W.
Washington,D.C.20006
202-785-8940 ex 108
www.plexusconsulting.com
www.iasbda.com
pchepuvavage@plexusconsulting.com