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Dear Sir / Madam,

I am writing to accept the invitation to comment on reformations to short interest rules.

There are three principle areas the proposed rules should cover:

- share ownership prior to completing a short sale
- public declaration of short positions in securities, exchange traded funds (ETFs), and/or derivatives
- increased penalties for misreporting or abuse

I shall attempt to summarise the extensive and detailed works that are publicly available as I best understand them.

1. Introduction

There is little argument that short selling is a legitimate part of securities trading. Where there are gains to be had from a natural decline in a business, this should be both discoverable and exploitable. In this case, the owner of a stock can lend their physical shares out for a fee and the short seller use those shares to bet on the stock going down. However, this differs from "naked shorting" whereby the same bets are made with synthetically created shares with no physical shares to back them up.

One of the key issues raised by the entire "Gamestop" saga is the apparent abuse of the short selling mechanics currently in place. The supposedly illegal "naked shorting" has been shown to be carried out extensively with a variety of tactics employed to hide short interest or "kick the can" by using option spreads to reset the share delivery timer.

In simple terms, shares have been created under the banner of "market making" to provide liquidity. This has been shown to create synthetic shares far above the public float of a given company - for Gamestop this was reported at 140%, the maximum legally reportable, but has been stated as over 220% in the RobinHood IPO documentation. Depending on your source, calculations range from these figures to as high as 1,000%. This means that the average value of a given share is diluted and that market makers, or those parties controlling multiple entities within the security trading infrastructure, are able to artificially affect price, demand, and even price discovery.

When these synthetic shares are due to be delivered, a variety of tactics are then employed to reset the T+x timer. This results in a skewed market that is tilted heavily in the favour of those able to access such mechanisms. It also provides a sizeable reporting black hole that stops investors from being able to make fully informed decisions or the security to be manipulated further.

This has led to companies being driven into the ground and bankrupted for the financial benefit of a small cadre of predatory actors. By combining the manipulation of the security, media coverage, and even the personnel of a company, the flagrant rules abuse has resulted in the demise of companies and, in at least one case, the set back of cancer research by decades. The short selling, that is meant to promote price discovery and organically declining companies, is instead being weaponised to trade jobs and livelihoods for annual bonuses.

There are multiple cases of this being admitted publicly, without even needing to dive into past litigation. I am sure you excellent folks will have far greater knowledge of past cases where this occurs. A couple of public examples would be:

- James Cramer admits to openly defrauding companies and securities -> https://www.youtube.com/watch?v=k0884pzuJiY [youtube.com]
In summary, naked shorting is employed widely within the US securities trading system. It is used to manipulate prices, enrich an oligarchy, and defraud investors. Privileged parties are able to employ predatory and illegal tactics to mitigate the risks inherent to market trading and, therefore, tilt the favour towards themselves at the expense of the wider economy.

2. Proposal I: Enforce Share Ownership Prior to a Short Sale

If the problem stems from the difference between "short selling" and “naked short selling”, then the key problem here has to be how to prevent Failures to Deliver (FTDs). These are where a short-sold share cannot be physically located by T+x and, therefore, a second synthetic share is being created to cover the first. This rolling snowball of synthetic shares covering synthetic shares allows participants to perpetually not adhere to their fiduciary duty.

However, this would become significantly more difficult if proof of ownership was required prior to a short sale. Whilst we can sit here and dream of a full blockchain enabled market, there are established ways and means to ensure a given security is both owned by the seller and within the bounds of a company's public float. Recent filings have shown that share marking is being more widely adopted, but this is just one step towards a fully accountable market.

A byproduct of this approach is to ensure that the number of available, tradeable shares should never exceed the publicly available float. If there are 10,000,000 shares available, and 10,000,000 shares are owned, then any synthetic share creation would raise that above the maximum threshold and should trigger a rejection of the transaction.

Let's create an example for demonstration purposes. Under the current system, Bob has short sold 100 shares. T+x approaches, and Bob needs to return those shares to their rightful owner. Bob goes to the market and looks to buy 100 shares but... oh no! There are no shares available to buy below Bob's price point.

Under the current system, Bob calls up his friend Sally and asks Sally to create 100 synthetic shares, for a fee, using Sally's market privelege and some clever number shuffling. Sally sells Bob those shares, Bob can then send them to the original owner and has T+x days to worry about settling his debt to Sally.

Under the new proposal, Sally would not be able to create the shares because, in doing so, the 100 shares would exceed the number of available shares in the system (and all of the float is already owned!). Bob would have to raise his price point to settle his debt to the original owner, perhaps at a loss.

A counter-argument to this is that T+2 settlement can mean opportunities are lost. This is true, but there are multiple proposals to lower settlement time to T+1 or T+0. It is in these settlement times that certain manipulative practices can also be undermined, but not the subject of this email. I will let far wiser minds cover that elsewhere. The focus here should be on lowering that settlement time, thereby improving the wider market.

So, in summary, prior to any short-side transaction being approved, ensure the shorting party owns the stock.

3. Proposal II: Introduce Stricter Public and Private Reporting Standards

One of the other key problems here is the smoke and mirrors used to misreport, misdirect, or just plain lie to authorities and market participants.

The general argument here is that greater reporting would lead to trading strategies being exposed and, therefore, natural market advantage being lost to competitors. This is true, therefore the proposal addresses both public and private reporting standards: public for reports to the general populace, and private to government and regulatory agencies. 

Up until January, Citron Research used available data to produce a report of short interest. These figures were pulled from priveleged sources not generally available to the wider public - the Bloomberg terminal, for example, costs
$2,000 per month. However, it demonstrates that short interest reporting has been in the hands of private firms for some time and not necessarily in the public’s best interest - Citron Research shut its reporting down when it was discovered it was being used by retail investors to assess Gamestop and other stocks.

The principle problem here is the ease by which misreporting can be achieved. There are a lot of market mechanisms that can be used to move perceived share ownership about. "We covered our shorts" is a phrase often used by participants in the Gamestop saga, but this is demonstrably untrue - the shorts were simply moved into ETFs, covered using option spreads, or marked as long trades.

All short positions should be reported against a given security. This should be broken down into ownership of the security, individual ETFs containing said security, and derivatives relating to said security. This should be non-negotiable and reported to the SEC on a daily basis. This would be privately held but available to the relevant authorities for monitoring, analysis, and fraud prevention.

This daily reporting should then be aggregated to a publicly viewable record through the SEC website. Any investor should then be able to see the aggregated short position of all participants against a given security (but not which participants are involved!), thus giving a true picture of the short positions whilst protecting those involved.

For example, Companies A, B, and C have 1,000, 2,000, and 5,000 securities sold short in Bob's Shoes. To the SEC, they declare this daily. On the SEC portal, the aggregated view shows Bob's shoes has 8,000 short-sold securities.

In summary, have a private reporting mechanism covering all forms of a given security, updated daily, and aggregated to a publicly accessible portal.

4. Proposal III: Revised Penalties for Failure to Adhere to Rules

I have to be careful here that not all manipulations and predatory practices are classed as illegal. Rule bending, sure, but not necessarily breaking the law.

At the moment it is generally accepted that FINRA, SEC, and other regulatory penalties are nothing more than a slap on the wrist. Often these are limited to civil actions that are considered the cost of doing business. A company can make billions exploiting a loophole, only to pay a tiny percentage when (and if) they are caught. Furthermore, these investigations can take years to complete and often action is taken long after the fact. This undermines the perception that the authorities are acting in their best interests and faith in the overall market. There is simply no risk for parties misbehaving.

Additionally, there seems to be no common sense approach to how legal matters impact the company continuing to do business. For example, despite being the subject of multiple class action lawsuits, the Robinhood IPO has been approved. Take a moment to let that sink in. A company being sued on multiple fronts for defrauding its customers is allowed to profit from going public.

So, firstly, the penalties here need to be far more severe. What needs to be looked at is moving away from flat fee penalties to percentage of income based, and those percentages increased to a maximum of 100%. A fine should not be the "cost of doing business", but a clear message that a party had broken the rules and had been penalised for doing so. If there is no risk to breaking the rules then parties will continue to do so.

As an aside on severe penalties, transitioning from civil to federal charges may seem like a sensible idea, but this would create an even bigger issue where the burden of proof to secure a conviction would be that much greater (meaning longer investigation times, and even slower system!).

Secondly, additional penalties should be introduced and enforced more consistently. A first minor infraction borne of a genuine mistake? A relatively small penalty. Thousands of reporting failures, repeat offences, or outright illegal activity? Suspension of trading licence, freezing of assets, and jail time. It's that simple.

Stopping the revolving door between the SEC and industry may also be a good idea, but a subject for another time! Put a rule in requiring 6 months post-SEC departure before taking a private sector role. It's not rocket science!
In summary, there is currently little to no risk of breaking regulations. Light slaps on the wrist are seen as the cost of doing business. Revising the approach here and enforcing punishments would send a strong message to those engaged in illegal short selling activity.

5. Conclusion

It is deeply hoped that the practices used by market participants in the wake of the Gamestop saga have shown the authorities the lengths market participants will go to navigate around the massively complicated rules of the stock market. If the financial authorities are able to make any of this stick, however, remains to be seen and, at best, the public won't hold its breath to see the participants punished beyond a light tickle.

The parties involved here are not market friendly. They are predators siphoning money from the economy and enriching themselves at the expense of those making an honest living. There is an illusion that stopping their manipulative practices will harm the market; this is simply a lie generated by the same media engine used to discredit legitimate parties and promote ignorance. It is hoped that any future rule changes, even if the proposals above are entirely disregarded, can bring justice to those enriching themselves at the expense of you, me, and the rest of the 99%.

Thank you for reading

A Investor