

Wall Street's Trade Settlement Dilemma

Source: <http://sci.tech-archive.net/Archive/sci.econ/2004-09/0177.html>

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Date: 09/04/04

Date: Fri, 3 Sep 2004 22:15:42 -0500

<http://www.investigatethesecond.com/DavePatch29.html>

Have you ever purchased something by mail order and never received it? What about ordering something that was due in 3 – 5 weeks but hasn't showed up some 8 weeks later? While you may get upset and place a few phone calls to the distributor, on Wall Street non-delivery is not only standard practice it is acceptable practice. Because of the way Wall Street operates, under a façade of Privacy Rights; you are never informed of the non-delivery. Wall Street will take your money and hand out IOU's in your account for the shares you purchased. They call it journal entry of "Settlement Failures".

When I have taken the opportunity to order something on-line, and it hasn't arrived within a reasonable timeframe I call and search for answers on where my purchased item is. After all, I paid for it and now I expect to receive it. If the purchased item is too long in its delays, I will even cancel the order and ask for a full refund. That is the rights of any person who puts money up for goods sold. When the distributor makes a habit of these delays, I may even contact the Better Business Bureau regarding their business practices. So why is Wall Street exempt from making timely delivery of purchased goods even though the Securities Act itself explicitly requires them to make "prompt" delivery and transfer of ownership of shares?

Recently the Securities and Exchange Commission passed a reform package, Regulation SHO that allows the industry to fail on the delivery of purchased shares as "Normal Operating Practice". The SEC's new rule does not contain market-based resolutions to the settlement failures that have abused and manipulated our stocks but instead relies on market integrity and enforcement based threats to deter future manipulation. We have all heard that venue before. Investors can only question why the SEC does not consider settlement a critical component of market integrity. Congress did when they adopted Section 17A of the Securities Act.

Today, the SEC identifies that 4% of all publicly traded securities have abusive settlement failures and at times those failures will exceed the entire public float of companies. As investors, we have made those phone calls we would make to a distributor of goods and asked our Brokers for receipt of the stocks we purchased. Instead of service we get excuses. "The shares show up in your account so you can sell them at any point in

time". Sure they do but they are not real shares until you make good on settlement and I do not want to sell them, I only want to control the illegal dilution that creates an imbalance between supply and demand and hurts my investment. Why can't my Broker simply get me my shares? When you ask to cancel the trade because it has taken too long without delivery they say "You can't, we have already sent your cash over and cannot get it back". Funny, I don't have them and neither do you but I can't cancel the trade?

To date the SEC has taken sides with the Industry firms as they show no concern for the ill effects of settlement failure dilution on our investments. The Industry makes tremendous revenues by increasing trade volumes and liquidity and that is what this game is ultimately about. The SEC simply re-states what our brokers tell us when they say; "The shares are in your account and you can sell them when ever you want". Formal complaints to the SEC and NASD, when clients demand shares, are automatically closed out as no-fault found yet; we still don't have proof of ownership. The Investors money is gone but the shares are nowhere to be seen.

So how bad is this issue?

In 1999 the SEC went out for public comment on a concept release pertaining to Short Selling. One comment they received came from a Senior Member and Director of Compliance and Operations for an NASD Member firm. This ranking officer claims "market makers and broker/dealers have rigged the game so they can play by a different set of rules than the general public and, to date, this has been protected by the regulatory bodies". This Officer then proceeds on by Stating "Every day, market pros short sell IPO's, short sell on downticks, and short sell without regard to the availability of certificates, all things done at the expense of individual investors, who do not have the right to do the same." To this extent, the issues addressed in this memo exist to this very day unchanged.

<http://www.sec.gov/rules/concept/s72499/loverde1.txt>

We can now fast forward nearly 5 years to 2004 where again a Senior Executive from the Industry also commented to the SEC on the issues of trade settlement and the Industry practices. According to Mike Alexander, Executive VO of Charles Schwab, "The NYSE and other SRO's have had trade affirmation rules on their books for some time. However, such rules have not been effective in changing the behavior of Buy-Side firms or their custodians; nor do the rules provide assurance that the affirmed trade will settle". And going on to say "We believe that only by holding all market participants directly accountable for making required affirmations will the necessary changes to behavior occur".

<http://www.sec.gov/rules/concept/s71304/charlesschwab061604.pdf>

or.

The North American Securities Administrators Association (NASAA) provides insight into the issue of failed settlements by declaring investors as victims of unscrupulous members. In their comment letter to the SEC the

NASAA called the naked shorting a "Bear Raid" tactic that should not be allowed to continue and requested the SEC to provide for tough measures in holding the industry responsible. The NASAA went so far as to provide clear direction to the SEC when they stated "If the Commission continues to allow settlement failures, it may well facilitate the harm that the proposal is designed to remedy." Again the SEC ignored the insight when they drafted Regulation SHO. <http://www.sec.gov/rules/proposed/s72303/nasaa010504.htm>

The Dilemma:

In the early 1980's the rules changed regarding how trades would be settled.

The SEC and DTCC created a "Book-Entry System" by which physical ownership never exchanged hands, only electronic ownership of shares took place. We became reliant on Computers to keep track of what was going on instead of the physical paper that originated in the market-place. The Markets were addressing efficiency and the paper crisis at the same time

With the reliance on Electronic transfers, the Industry ignored settlement completely. The Computers can keep track of what is necessary so let's just trade stocks with impunity. The result, more settlement failures and unbalanced books than any one person could imagine. Shareholders were trading in record volumes but what exactly were they trading? The SEC, SRO's and the Industry knew. We were trading future IOU's manifested by industry greed and fraud.

The SEC and SRO's became part of the process as they ignored the cries for help by small business issuers and investors alike. The Short selling concept review in 1999 may have informed them of the problem but by then it was already too late to address so it became best to simply cover it up. The Regulators could not go after the industry because the industry would blame the Regulators for telling them it was acceptable behavior in the first place. A statement that reins true to this day.

So what's next?

If it were up to Wall Street and the regulators we would all simply dry up and go away. The SEC will proceed on by shutting down non-filing companies and that will begin to erase the unsettled trade burdens.

The SEC has already pulled as many as 40 registrations from shell companies due to non-filing status. The SEC has never addressed exactly what happens to those shareholders whose broker created an unsettled trade into their account but most surmise that the Broker will be able to keep the profits on the sale of that unregistered share. We have asked where these shells reside within that 4% above threshold category but the SEC refuses to address those questions.

The SEC and industry will also continue to beat down the spirits of investors affected by this abuse and the companies they invested in. It is not hard to do as it is generally the middle class or so that invest this way. The SEC figures that a lack of political power and clout will drown

out the cries for help. The Regulators start by harassing the company with needless but costly activities and the industry simply imposes 'Sell-Only' Restrictions on these abused stocks.

Sell-Only restrictions is a process where the Firm will allow their clients to only Sell their holdings but will not allow them to purchase any more. The Firms, as well as the regulators, will tell investors it is for their own best interests but we know better. A spokesman for the NASD told me that the "Sell Only" restriction protects me because the firm is aware that the trade will not settle. The Industry flooded the markets with too many shares so it is in my best interest to not purchase any more. Fact is, the failures were created by the industry and the restriction really protects their liability should they ever have to go in and buy the stock themselves to settle. The Industry members do not want to buy when they have to compete with real shareholders. The regulators approve of this rigging in our capital markets.

So the Industry and the regulators have boxed themselves in a corner and they have a dilemma. Do we continue with the fraud we have taken advantage of these past 20 years or do we change our behavior and become ethical for the sake of future generations? Based on the historical past of late, this greedy and incompetent generation of individuals will merely operate under status quo and hope that people like myself lose steam and drift off.

NEVER! The Middle Class is the working class and the rich and powerful have never figured out the resolve of the working forces. It has always come too easy for them and they do not understand passion and drive.

For the record, I have asked the SEC on several occasions to explain why the industry cannot meet a settlement timeline of 13 days on all trades and they have never provided any rationalizations. It is a SECRET. So much for transparency. The SEC would rather have this fight continue instead of rationalizing their latest law.

For more on this issue please visit the Host site at www.investigatethesec.com .