

A House of Cards

by [u/atobitt](#)

Part I

Summary: The DTC has been taken over by big money. They transitioned from a manual to a computerized ledger system in the 80s, and it played a significant role in the 1987 market crash. In 2003, several issuers with the DTC wanted to remove their securities from the DTC's deposit account because the DTC's participants were naked short selling their securities. Turns out, they were right. The DTC and its participants have created a market-sized naked short selling scheme. All of this is made possible by the DTC's enrollee- Cede & Co.

The events we are living through RIGHT NOW are the 50-year ripple effects of stock market evolution. From the birth of the DTC to the cesspool we currently find ourselves in, this DD will illustrate just how fragile the House of Cards has become. We've been warned so many times... We've made the same mistakes so many times. And we never seem to learn from them.

In case you've been living under a rock for the past few months, the DTCC has been proposing a boat load of rule changes to help better-monitor their participants' exposure. If you don't already know, the DTCC stands for Depository Trust & Clearing Corporation and is broken into the following (primary) subsidiaries:

1. Depository Trust Company (DTC) - centralized clearing agency that makes sure grandma gets her stonks and the broker receives grandma's tendies
2. National Securities Clearing Corporation (NSCC) - provides clearing, settlement, risk management, and central counterparty (CCP) services to its members for broker-to-broker trades
3. Fixed Income Clearing Corporation (FICC) - provides central counterparty (CCP) services to members that participate in the US government and mortgage-backed securities markets

Brief history lesson: I promise it's relevant (this [link](#) provides all the info that follows).

The DTC was created in 1973. It stemmed from the need for a centralized clearing company. Trading during the 60s went through the roof and resulted in many brokers having to quit before the day was finished so they could manually record their mountain of transactions. All of this was done on paper and each share certificate was physically delivered. This obviously resulted in many failures to deliver (FTD) due to the risk of human error in record keeping. In 1974, the Continuous Net Settlement system was launched to clear and settle trades using a rudimentary internet platform.

In 1982, the DTC started using a [Book-Entry Only](#) (BEO) system to underwrite bonds. For the first time, there were no physical certificates that actually traded hands. Everything was now performed virtually through computers. Although this was advantageous for many reasons, it made it MUCH easier to commit a certain type of securities fraud- naked shorting.

One year later they adopted [NYSE Rule 387](#) which meant most securities transactions had to be completed using this new BEO computer system. Needless to say, explosive growth took place for the next 5 years. Pretty soon, other securities started utilizing the BEO system. It paved the way for growth in mutual funds and government securities, and even allowed for same-day settlement. At the time, the BEO system was a tremendous achievement. However, we were destined to hit a brick wall after that much growth in such a short time.. By October 1987, that's exactly what happened.

["A number of explanations have been offered as to the cause of the crash... Among these are computer trading, derivative securities, illiquidity, trade and budget deficits, and overvaluation.."](#)

If you're wondering where the birthplace of High Frequency Trading (HFT) came from, look no further. The same machines that automated the exhaustively manual reconciliation process were also to blame for amplifying the fire sale of 1987.

CAUSE #2: COMPUTER TRADING

[Website, University of Melbourne:](#)

In searching for the cause of the crash, many analysts blame the use of computer trading (also known as program trading) by large institutional investing companies. In program trading, computers were programmed to automatically order large stock trades when certain market trends prevailed. However, studies show that during the 1987 U.S. Crash, other stock markets which did not use program trading also crashed, some with losses even more severe than the U.S. market.

The last sentence indicates a much more pervasive issue was at play, here. The fact that we still have trouble explaining the calculus is even more alarming. The effects were so pervasive that it was dubbed the [1st global financial crisis](#). Here's another great summary published by the [NY Times](#): "..to be fair to the computers.. [they were].. programmed by fallible people and trusted by people who did not understand the computer programs' limitations. As computers came in, human judgement went out." Damned if that didn't give me goosebumps...

Here's an EXTREMELY relevant [explanation](#) from [Bruce Bartlett](#) on the role of derivatives:

CAUSE #1: DERIVATIVE SECURITIES

[Bruce Bartlett, senior fellow with the National Center for Policy Analysis of Dallas, Texas:](#)

Initial blame for the 1987 crash centered on the interplay between stock markets and index options and futures markets. In the former people buy actual shares of stock; in the latter they are only purchasing rights to buy or sell stocks at particular prices. Thus options and futures are known as derivatives, because their value derives from changes in stock prices even though no actual shares are owned. The Brady Commission [also known as the Presidential Task Force on Market Mechanisms, which was appointed to investigate the causes of the crash], concluded that the failure of stock markets and derivatives markets to operate in sync was the major factor behind the crash.

Notice the last sentence? A major factor behind the crash was a disconnect between the price of stock and their corresponding derivatives. The value of any given stock should determine the derivative value of that stock. It shouldn't be the other way around. This is an important concept to remember as it will be referenced throughout the post. In the off chance that the market DID tank, they hoped they could contain their losses with [portfolio insurance](#). Another [article from the NY times](#) explains this in better detail.

Portfolio insurance would let them get out with minimal damage if markets ever began to fall. They would simply sell ever-increasing numbers of futures contracts, a process known as dynamic hedging.

The short position in futures contracts would then offset the losses caused by falls in the stocks they owned.

Portfolio insurance did not start the widespread selling of stocks in 1987. But it made sure that the process got out of hand. As computers dictated that more and more futures be sold, the buyers of those futures not only insisted on sharply lower prices but also hedged their positions by selling the underlying stocks. That drove prices down further, and produced more sell orders from the computers. At the time, many people generally understood how portfolio insurance worked, but there was a belief that its very nature would assure that it could not cause panic. Everyone would know the selling was not coming from anyone with inside information, so others would be willing to step in and buy to take advantage of bargains. Or so it was believed.

But when the crash arrived, few understood much of anything, except that it was like nothing they had ever seen. Anyone who did step in with a buy order quickly regretted the decision.

A major disconnect occurred when these futures contracts were used to intentionally tank the value of the underlying stock. In a perfect world, organic growth would lead to an increase in value of the company (underlying stock). They could do this by selling more products, creating new technologies, breaking into new markets, etc. This would trigger an organic change in the derivative's value because investors would be (hopefully) more optimistic about the longevity of the company. It could go either way, but the point is still the same. This is the type of investing that most of us are familiar with: investing for a better future.

I don't want to spend too much time on the crash of 1987. I just want to identify the factors that contributed to the crash and the role of the DTC as they transitioned from a manual to an automatic ledger system. **The connection I really want to focus on is the ENORMOUS risk appetite these investors had. Think of how overconfident and greedy they must have been to put that much faith in a computer script.. either way, same problems still exist today.**

Finally, the comment by Bruce Bartlett regarding the mismatched investment strategies between stocks and options is crucial in painting the picture of today's market. Now, let's do a super brief walkthrough of the main parties within the DTC before opening this can of worms.

I'm going to talk about three groups within the DTC- **issuers, participants, and Cede & Co.**

Issuers are companies that issue securities (stocks), while participants are the clearing houses, brokers, and other financial institutions that can utilize those securities. Cede & Co. is a subsidiary of the DTC which holds the share certificates.

Participants have MUCH more control over the securities that are deposited from the issuer. Even though the issuer created those shares, participants are in control when those shares hit the DTC's doorstep. The DTC transfers those shares to a holding account (Cede & Co.) and the participant just has to ask "*May I haff some pwetty pwease wiff sugar on top?*"

Now, where's that can of worms?

Everything was relatively calm after the crash of 1987... until we hit 2003.

deep breath

The DTC started receiving several requests from issuers to pull their securities from the DTC's depository. I don't think the DTC was prepared for this because they didn't have a written policy to address it, let alone an official rule. Here's the half-assed response from the DTC:

including its book-entry transfer system. The securities are held by DTC in its nominee name for the benefit of its participants. **DTC has stated that, in its opinion, these issuers have no legal or beneficial interest in the securities they are requesting to be withdrawn from DTC.**

Realizing this situation was heating up, the DTC proposed [SR-DTC-2003-02](#).

DTC's proposed rule change provides that upon receipt of a withdrawal request from an issuer, DTC will take the following actions: (1) DTC will issue an Important Notice notifying its participants of the receipt of the withdrawal request from the issuer and reminding participants that they can utilize DTC's withdrawal procedures if they wish to withdraw their securities from DTC; and (2) DTC will process withdrawal requests submitted by participants in the ordinary course of business but will not effectuate withdrawals based upon a request from the issuer.

Honestly, they were better off WITHOUT the new proposal.

It became an even BIGGER deal when word got about the proposed rule change. Naturally, it triggered a TSUNAMI of comment letters against the DTC's proposal. There was obviously something going on to cause that level of concern. Why did SO MANY issuers want their deposits back?

...you ready for this shit?

As outlined in the DTC's opening remarks:

II. Description

Recently a number of issuers of securities have independently requested that DTC withdraw from the depository all securities issued by them.⁴

OK... see footnote 4...

⁴ As explained in further detail by many of the commenters opposing DTC's proposal, the issuers making these requests have alleged that their securities have been the target of manipulative short sellers.

UHHHHHHH WHAT!?!? Yeah! I'd be pretty pissed, too! Have my shares deposited in a clearing company to take advantage of their computerized trades just to get kicked to the curb with NO WAY of getting my securities back... AND THEN find out that the big-dick "participants" at your fancy DTC party are literally short selling my shares without me knowing?!

....This sound familiar, anyone??? IDK about y'all, but this "trust us with your shares" BS is starting to sound like a major con.

The DTC asked for feedback from all issuers and participants to gather a consensus before making a decision. All together, the DTC received 89 comment letters (a pretty big response). 47 of those letters opposed the rule change, while 35 were in favor. To save space, I'm going to use smaller screenshots. Here are just a few of the opposition comments.

Dear Senator Lieberman:

My firm represents Flight Safety Technologies, Inc. ("FST") whose shares are traded on the NASD Over-The-Counter Bulletin Board ("OTCBB"). We are writing to enlist your support of our request to the SEC to conduct an investigation into naked shortselling of shares of small cap companies on the OTCBB.

FST is concerned that it, along with numerous other small-cap companies, has been the target of "naked shortselling". Naked shortselling occurs when a party sells shares of a company without making an affirmative determination that it can borrow shares to "cover" those that it has sold. The purpose of naked shortselling is to drive down the share price of the targeted company. In contrast to the national exchanges (NYSE, AMEX and NASDAQ), there are virtually no regulatory guidelines that apply to short sales of OTCBB traded small-cap companies.

I have attached a comment letter that we recently sent to the Securities and Exchange Commission. In our letter, we urge the SEC to (1) deny a requested rule change from the Depository Trust Company that would make it harder for a company such as FST to track and expose illegitimate short sales and (2) conduct an investigation into naked shortselling of small cap companies.

We would greatly appreciate it if you could contact the SEC, Division of Market Regulations, Margaret H. McFarland, Deputy Secretary, 450 5th Street, N.W., Washington, D.C. 20549, to urge it to vigorously investigate this growing and serious problem.

<https://www.sec.gov/rules/sro/dtc200302/srdtc200302-89.pdf>

And another:

From: Bob Rondeau [Bob@caesy.com]
Sent: Tuesday, May 20, 2003 10:49 AM
To: 'rule-comments@sec.gov'
Subject: DTC rules changes

Sirs,

As an investor who has been continually burned by an inefficient and poorly organized DTC as relates to naked short selling, I urge you to allow companies to continue to withdraw from the DTC at their discretion. The current climate of investing, fostered and perpetuated by the DTC is scandalous and ruinous for the individual investor. Confidence in the system is bankrupt...changes must be made....and fast.

Robert S. Rondeau

<https://www.sec.gov/rules/sro/dtc200302/rsrondeau052003.txt>

AAAAAAAAAAND another:

From: Michael Sondow [msondow@iciiu.org]
Sent: Friday, April 04, 2003 10:38 PM
To: rule-comments@sec.gov
Subject: SR-DTC-2003-02 - SEC: Proposed Rule on Restriction of
Withdrawal of Stock Certificates from Depository Trust Corp to
Shareholder Action

Dear SEC-

Regarding the proposed rule that would restrict the withdrawal of stock certificates from the DTC to shareholder action, rather than by company request:

This rule should not be passed because, by permitting the settlement of so-called "short" trades by traders not holding share certificates, the Depository Trust Corporation has shown itself to be incompetent to uphold the law and stop illegal naked short selling, if not complicit in such practices, and therefore a company's only protection from an attack on its stock by such criminal activity may be to withdraw unilaterally from the DTC settlement system.

If the SEC cannot prevent illegal short selling, and is unable to police and regulate the DTC to make certain rules are being followed, it must allow the companies whose shares are under attack to protect their investors by withdrawing those shares from the system - the DTC - where they are vulnerable to such attacks.

In the end, a free market will correct abuses. But if the SEC constrains the market, by regulating how and where a company may settle the trades of its shares, in a way that results in unfair practices by which individual investors are hurt, it is guilty of both denying the play of free market forces and of forcing investors and companies into an obligatory system of abuse.

In short, the proposed rule will foster further abuses and undermine the already decreased public confidence in the stock market.

Yours,
Michael Sondow
(A concerned private investor)

<https://www.sec.gov/rules/sro/dtc200302/msondow040403.txt>

Here are a few in favor.

All of the comments I checked were participants and classified as market makers and other major financial institutions... go fucking figure.

April 23, 2003

Re: ⁰² File No. SR-DTC-2003-03 "Proposed Rule Change Concerning **Requests for Withdrawal of Certificates by Issuers**"

Dear Mr. Katz:

UBS Warburg LLC is pleased to provide the Securities and **Exchange** Commission with comments on the above-referenced proposed **rule** change.

UBS Warburg LLC believes the proposed rule **change** is consistent with the securities industry's initiative toward straight-through processing and decertification. Returning to physical securities is contrary to the recommendations of the Group of **Thirty** and would engender operational and clearance risk that the securities industry and **the broader** economy can ill afford.

Accordingly, **UBS Warburg LLC** supports the Depository Trust Company's proposed rule change concerning requests for withdrawals of certificates by issuers. .

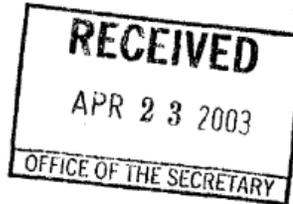
<https://www.sec.gov/rules/sro/dtc200302/srdtc200302-82.pdf>

Two



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Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-0609



Re: Proposed Rule Change by The Depository Trust Company Relating to Issuers Requests for Withdrawal of Certificates. [Release No. 34-47365; File No. SR-DTC-2003-02].

Dear Mr. Katz:

Merrill Lynch welcomes the opportunity to comment on the proposed **rule** filing by The Depository Trust Company (DTC) under which "DTC will only honor requests **for** withdrawal of certificates submitted **by** its participants and not by the issuer of the securities."

Merrill Lynch actively supports industry efforts to achieve Straight Through Processing (STP) in the clearance and settlement of U.S. securities. A significant building block of this effort is dematerialization-- eliminating the issuance, use, transfer and retention of physical securities. Achievement of STP and dematerialization will reduce risk and costs to investors and all market participants and create greater market efficiencies.

The industry recognizes the need to support registered ownership and DTC's Direct Registration Service (**DRS**) provides a vehicle in an effective and safe environment. DRS enables the electronic movement of securities between the transfer agents and the participants in DTC. The service offers registered shareowners a reliable alternative to physical certificates and eliminates the risks, delays and costs associated with completing a securities transaction in certificated form.

In recent months, a number of issuers have announced plans to withdraw their certificates from DTC and move to exclusively certificated ownership of their shares. These plans to perpetuate a physical certificate environment are contradictory to industry efforts to achieve STP and dematerialization. The investing public will be especially inconvenienced in that they will bear the burden of the extra effort required to complete securities transactions, the risk of **missed** market opportunities and the cost of replacing lost certificates.

Merrill Lynch fully supports DTC's **proposal**. We find it consistent with the industry's STP efforts and urge the Commission to adopt **the** proposed rule change.

<https://www.sec.gov/rules/sro/dtc200302/srdtc200302-81.pdf>

Three



April 21, 2003

Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-0609

Re: File No. SR-DTC-2003-03; Request for Withdrawal of Certificates by Issues

Dear Mr. Katz:

We would like to take this opportunity to comment on the proposed rule filing by The Depository Trust Company (DTC) to honor requests for withdrawal of certificates submitted by its participants and not by the issuers of the securities.

RBC Dain Rauscher Inc., a broker-dealer, serves individual investors and small business owners through offices across the United States, and capital markets and correspondent clients in select U.S. and international markets. RBC Dain Rauscher believes we are well positioned to understand and meet the service needs of our customers in respect to the handling of their securities.

The industry goal is to achieve Straight Through Processing (STP) and ultimately migrate to T+1 settlement. Achievement of STP processing will reduce costs to customers, reduce settlement risk, and create greater market efficiencies. In connection with a study to determine obstacles to STP, a major effort was made to analyze all reasons by retail customers to hold physical certificates and to determine appropriate alternatives. The answer was that the Direct Registration System (DRS) was established to enable owners to be held directly on the books of the issuer, in lieu of receiving a physical certificate. DRS provided many of the benefits of STP while giving share owners the convenience of holding certificates without a brokerage intermediary.

At a board meeting held January 9, 2003, the Securities Industry Association (SIA) endorsed an initiative that focuses on eliminating physical certificates. Further supporting this initiative is AT&T's decision to dematerialize a recent corporate action event and request shareholders to exchange their certificates for book-entry ownership. The industry plan to dematerialize certificates is a significant building block toward STP and the plan must continue to evolve.

<https://www.sec.gov/rules/sro/dtc200302/rbcdain042303.pdf>

Here's the [full list](#) if you wanna dig on your own.

...I realize there are advantages to "paperless" securities transfers... However... It is EXACTLY what Michael Sondow said in his comment letter above.. We simply cannot trust the DTC to protect our interests when we don't have physical control of our assets.

Several other participants, including Edward Jones, Ameritrade, Citibank, and Prudential overwhelmingly favored this proposal. How can someone NOT acknowledge that the absence of physical shares only makes it easier for these people to manipulate the market?

This rule change would allow these 'participants' to continue doing this because it's extremely profitable to sell shares that don't exist, or have not been collateralized. Furthermore, it's a win-win for them because it forces issuers to keep their deposits in the holding account of the DTC...

Ever heard of the fractional reserve banking system?? Sounds A LOT like what the stock market has just become.

Want proof of market manipulation? Let's fact-check the claims from the opposition letters above. I'm only reporting a few for the time period we discussed (2003ish). This is just to validate their claims that some sketchy shit is going on.

1. [UBS Securities](#) (formerly UBS Warburg):
 - A. pg 559; SHORT SALE VIOLATION; 3/30/1999
 - B. pg 535; OVER REPORTING OF SHORT INTEREST POSITIONS; 5/1/1999 - 12/31/1999
 - C. PG 533; FAILURE TO REPORT SHORT SALE INDICATORS; INCORRECTLY REPORTING LONG SALE TRANSACTIONS AS SHORT SALES; 7/2/2002
2. [Merrill Lynch](#) (Professional Clearing Corp.):
 - A. pg 158; VIOLATION OF SHORT INTEREST REPORTING; 12/17/2001
3. [RBC](#) (Royal Bank of Canada):
 - A. pg 550; FAILURE TO REPORT SHORT SALE TRANSACTIONS WITH INDICATOR; 9/28/1999
 - B. pg 507; SHORT SALE VIOLATION; 11/21/1999
 - C. pg 426; FAILURE TO REPORT SHORT SALE MODIFIER; 1/21/2003

Ironically, I picked these 3 because they were the first going down the line. I'm not sure how to be any more objective about this. Their entire FINRA report is littered with short sale violations. Before anyone asks "how do you know they aren't ALL like that?" The answer is - I checked. If you get caught for a short sale violation, chances are you will ALWAYS get caught for short sale violations. Why? Because it's more profitable to do it and get caught, than it is to fix the problem.

Wanna know the 2nd worst part?

Several comment letters asked the DTC to investigate the claims of naked shorting BEFORE coming to a decision on the proposal.. I never saw a document where they followed up on those requests.....

NOW, wanna know the WORST part?

V. Conclusion

On the basis of the foregoing, the Commission finds that the proposed rule change is consistent with the requirements of the Act and in particular with the requirements of Section 17A(b)(3)(F) of the Act and the rules and regulations thereunder. IT IS THEREFORE

ORDERED, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (File No. SR-DTC-2003-02) be and hereby is approved.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.⁶⁷

Margaret H. McFarland
Deputy Secretary

https://www.sec.gov/rules/sro/34-47978.htm#P99_35478

The DTC passed that rule change.

They not only prevented the issuers from removing their deposits, they also turned a 'blind-eye' to their participants manipulative short selling, even when there's public evidence of them doing so...

....Those companies were being attacked with shares THEY put in the DTC, by institutions they can't even identify...

Let's take a quick breath and recap:

The DTC started using a computerized ledger and was very successful through the 80's. This evolved into trading systems that were also computerized, but not as sophisticated as they hoped.. They played a major part in the 1987 crash, along with severely desynchronized derivatives trading.

In 2003, the DTC denied issuers the right to withdraw their deposits because those securities were in the control of participants, instead. When issuer A deposits stock into the DTC and participant B shorts those shares into the market, that's a form of [rehypothecation](#). This is what so many issuers were trying to express in their comment letters. In addition, it hurts their company by driving down it's value. They felt robbed because the DTC was blatantly allowing it's participants to do this, and refused to give them back their shares.. It was critically important for me to paint that background.

now then....

Remember when I mentioned the DTC's enrollee- Cede & Co.?
[https://www.sec.gov/rules/sro/34-47978.htm#P19_6635 \(section II\)](https://www.sec.gov/rules/sro/34-47978.htm#P19_6635)

I'll admit it: I didn't think they were that relevant. I focused so much on the DTC that I didn't think to check into their enrollee...

..Wish I did....

You Don't Really Own Your Securities; Can Blockchains Fix That?

By Brian Patrick Eha July 27, 2016, 3:29 p.m. EDT 9 Min Read



If blockchain technology accomplishes nothing else in the capital markets, it is at least drawing attention to an unsettling fact: In the United States, publicly traded stock does not exist in private hands.

It is not owned by the ostensible owners, who, by virtue of having purchased shares in this or that company, are led to believe they actually own the shares. Technically, all they own are IOUs. The true ownership lies elsewhere.

While private-company stock is still directly owned by shareholders, nearly all publicly traded equities and a majority of bonds are owned by a little-known partnership, Cede & Co., which is the nominee of the Depository Trust Co., a depository that holds securities for some 600 broker-dealers and banks. For each security, Cede & Co. owns a master certificate known as the "global security," which never leaves its vault. Transactions are recorded as debits and credits to DTC members' securities accounts, but the registered owner of the securities — Cede & Co. — remains the same.

<https://www.americanbanker.com/news/you-dont-really-own-your-securities-can-blockchains-fix-that>

That's right.... Cede & Co. hold a "master certificate" in their vault, which NEVER leaves. Instead, they issue an IOU for that master certificate..

Didn't we JUST finish talking about why this is such a major flaw in our system..? And that was almost 20 years ago...

Here comes the mind fuck:

Part 8: Illegal Naked Shorting Series: Who or What is Cede and What Role Does Cede Play in the Trading of Stocks?

POSTED by LARRY SMITH on JUL 1, 2019 · (0) ■

You Really Don't Own the Shares that Appear in Your Brokerage Account; They Belong to Cede

Most investors when they buy a publicly traded stock believe that they own a part of some company. They think that somewhere there is a stock certificate or some indication of ownership that has their name on it, but this is not the case. When you buy a "stock" you are actually purchasing a security that affords certain entitlement rights related to registered stock which actual owners hold. The registered shares of a private company are directly owned by shareholders. In contrast, the registered shares of nearly all publicly traded equities are owned by Cede & Co., which is the nominee of the Depository Trust Company (DTC). (A nominee is a company whose name is given as having title to a stock, but does not receive the financial benefits of ownership.) Cede is a subsidiary of the Depository Trust Company (DTC) which is a subsidiary of the Depository Trust and Clearing Corporation (DTCC) and the DTCC is a private company owned by elite Wall Street firms and money center banks. If you need background or a refresher on DTC and DTCC, click on this link. Effectively, elite Wall Street firms and money center banks, not institutions and individual investors, own almost all of the registered shares of publicly traded companies in the US.

benefits such as dividends and to vote on corporate governance issues. While you may think you are buying registered stock, you are actually buying a financial derivative related to that stock. Effectively, you are buying a financial derivative from brokers of a financial derivative they hold from Cede that is just a digital entry in your DTC account.

<https://smithonstocks.com/part-8-illegal-naked-shorting-series-who-or-what-is-cede-and-what-role-does-cede-play-in-the-trading-of-stocks/>

Part II

Section 1: Pilot

I wasn't looking into GameStop when all of this began. Most of my time was spent researching the pandemic's impact on the economy. I'm talking about the economic steam engine that employs people and puts food on their tables. Especially the small businesses that were executively steamrolled by COVID lockdowns. It was scary how fast they had to close their doors.

I spent a lot of time looking at companies like GameStop. Brick-n-mortar businesses were basically running out of bricks to sh*t. Frankly, GameStop looked a lot like the next Blockbuster and it just seemed like a matter of time before they went under. Had DFV not done his homework, it's possible we wouldn't have a rocket to HODL or a story to TODL.

Whoever has/had a short position with GameStop was probably thinking the same thing. The number of shares that can be freely traded on a daily basis is referred to as "the float". GameStop has 70,000,000 shares outstanding, but 50,000,000 shares represented "the float". With a small float like this, a [short position of 20% becomes significant](#). Heck, Volkswagen got squeezed with just a [12.8%](#) short position. So let's use little numbers to walk through an example of how this works.

Assume VW has 100 shares outstanding. If 12.8% of the company has been sold short, then 12.8 shares (let's just say 13) must be available to purchase at a later date (assuming VW doesn't go bankrupt). However, VW had a float of 45% which meant there was no real strain to cover that 12.8% short position at any moment. However, when Porsche announced they wanted to increase their position in VW, they invested HEAVILY.

"The kicker was that Porsche owned 43% of VW shares, 32% in options, and the government owned 20.2%.... In plain terms, it meant that the actual available float went from 45% down to 1% of outstanding shares" (bullishbears.com/vw-short-squeeze/).

Let's revisit our scenario. With 100 shares outstanding and 13 shares sold short, what happens if only 1 share was available to cover instead of 45?



Well..... THIS:

GameStop is/was the victim of price suppression through short selling. I discussed this topic with [Dr. T](#) and [Carl Hagberg](#) in our [AMAs](#).

Every transaction has two sides- a buy and a sell. Short selling artificially increases the *supply* of shares and causes the price to decline. When this happens, the price can only increase if *demand* exceeds the increase in supply.

I started looking closely at GameStop after confirming their reported short position of [140%](#). It's important for me explain this why this is so much different than the VW example...

140% of GameStop's FLOAT was sold short. There were 50,000,000 shares in that float, so 140% of this was equal to the 70,000,000 shares the company has outstanding. This means AT LEAST 100% of their outstanding shares has been sold short. Now compare that to VW where the short position was only 12.8%... Simply put, it is mathematically impossible to cover more than 100% of a company's outstanding stock.

The *peak* of the VW squeeze was reached when the demand for shares became surpassed by the supply of those shares. Here, demand represents 12.8% of their stock which must be available to close the short position. With only 1% of shares available, this guaranteed a squeeze until the number of shares available to trade could satisfy the remaining short interest. When a company has a short position with more than 100% of total shares outstanding, the preceding argument is thrown out the window. Supply cannot surpass demand because the company can only issue 100% of itself at any given time. Therefore, the additional 40% could only be explained by multiple people claiming ownership of the same share... Surely this is a mistake.. right? I thought this level of short selling was impossible..

Until I saw the number of short selling violations issued by FINRA.

As we go through these FINRA reports, there are a few things to keep in mind:

1. **FINRA is not a part of the government.** FINRA is a non-profit entity with [regulatory powers set by congress](#). This makes FINRA the largest self-regulatory organization (SRO) in the United States. The SEC is responsible for setting rules which protect individual investors; FINRA is responsible for overseeing most of the brokers (collectively referred to as members) in the US. As an SRO, FINRA sets the rules by which their members must comply- **they are not directly regulated by the SEC**
2. FINRA investigates cases at their own pace. When looking at the "*Date Initiated*" on their reports, it is not synonymous with "*date of occurrence*". Many times, FINRA will not say when a problem occurred, just resolved. It can be YEARS after the initial occurrence. The [DTC participant report](#) is littered with cases that were initiated in 2019 but occurred in 2015, etc. Many of the violations occurring today will take years to discover
3. FINRA can issue a violation for each occurrence using a 1:1 format. When it comes to violations like short selling, however, these "occurrences" can last months or even years. When this happens, FINRA issues a violation for multiple occurrences using a 1:MANY format. I discussed this event in [Citadel Has No Clothes](#) where one violation represented FOUR YEARS of market f*ckery. What's sh*tty is that FINRA doesn't tell you which violations are which. You have to read each line and see if they mention a date range of occurrence within each record. If they don't, you must assume it was for one event...

BRUTAL

4. FINRA's investment portfolio is held by the same entities they are issuing violations to...
Let that sink in for a minute.

Section 2: State your case...

Can you think of a reason why short sellers would want to understate their short positions? Put yourself in their situation and imagine you're running a hedge fund...

You operate in a self-regulated (SRO) environment and your records are basically private. If the SEC asks you to justify suspicious behavior, you really don't have to provide it. The worst that could happen is a slap on the wrist. I wrote about this EXACT same thing in [Citadel Has No Clothes](#). They received a cease-and-desist order from the SEC on 12/10/2018 for failing to submit complete and accurate records. This 'occurred' from November 2012 through April 2016 and contained deficient information for over 80,000,000 trades. Their punishment... \$3,500,000... So why even bother keeping an honest ledger?

Now, suppose you short a bunch of shares into the market. When you report this to FINRA, they require you to mark the transaction with a short sale indicator. In doing so, FINRA builds a paper trail to your short selling activity.

However... if you omit this indicator, FINRA can't distinguish that transaction from a long sale. Who else would there be to hold you accountable for covering your position? This is especially true for self-clearing organizations like Citadel because there are less parties involved to hold you accountable with recordkeeping. If FINRA thinks you physically owned those shares and sold them (long sale), they have no reason to revisit that transaction in the future... You could literally pocket the cash and dump the commitment to cover.

Another very important advantage is that it allows short sellers to artificially increase the supply of shares while understating the outstanding short interest on that security. The supply of shares being sold will drive down the price, while the short interest on the stock remains the same.

So.. aside from paying a fine, how could you possibly lose by "forgetting" to mark that trade with a short sale indicator? It would seem the system almost incentivizes this type of behavior. I combed through the [DTC participant report](#) and found enough dirt to fill the empty chasm that is Ken Griffin's soul. Take a guess at what their most common short selling violation is.. I'm going to assume you said **"FAILING TO PROPERLY MARK A SHORT SALE TRANSACTION"**.

For the record, I just want to say I called this in March when I wrote [Citadel Has No Clothes](#). Citadel has one of the highest concentrations of short selling violations in their FINRA report. At the time, I didn't fully understand the consequences of this violation... After seeing how many participants received the same penalty, it finally made sense.

There are roughly 240 participant account names on the DTC's list. Sh*t you not, I looked at every short selling violation that was published on [Brokercheck.finra.org](#). To be fair, I eliminated participants with only 1 or 2 violations related to short selling. There were PLENTY of bigger fish to fry.

I literally picked the first participant at the top of the list and found three violations for short selling.

cracks knuckles

[ABN AMRO Clearing Chicago LLC](#) (AACC) is the 3rd largest bank in the Netherlands. They got popped for three short selling violations, one of which included a failure-to-deliver. In total, they have 78 violations from FINRA. Several of these are severe compared to their violations for short selling. However, the short selling violations revealed a MUCH bigger story:

Disclosure 36 of 78

Reporting Source:	Regulator
Current Status:	Final
Allegations:	WITHOUT ADMITTING OR DENYING THE FINDINGS, THE FIRM CONSENTED TO THE SANCTIONS AND TO THE ENTRY OF FINDINGS THAT IT FAILED TO REPORT SHORT INTEREST POSITIONS TO THE NEW YORK STOCK EXCHANGE AND FINRA FOR SAMPLE SETTLEMENT DATES AND SUBMITTED TO FINRA AN INACCURATE SHORT INTEREST POSITION REPORT. THE FINDINGS STATED THAT THE FIRM'S SUPERVISORY SYSTEM DID NOT PROVIDE FOR SUPERVISION REASONABLY DESIGNED TO ACHIEVE COMPLIANCE WITH RESPECT TO THE APPLICABLE SECURITIES LAWS AND REGULATIONS, AND FINRA AND NASD RULES, CONCERNING SHORT-INTEREST REPORTING. SPECIFICALLY, THE FIRM'S SUPERVISORY SYSTEM DID NOT INCLUDE WRITTEN SUPERVISORY PROCEDURES PROVIDING FOR A STATEMENT OF THE SUPERVISORY STEP(S) TO BE TAKEN BY THE IDENTIFIED PERSON(S).

So... ABN AMRO submitted an inaccurate short interest position to the NYSE and FINRA and lacked the proper supervisory systems to comply with... practically everything... In 2014, AMRO forked over \$95,000 to settle this and didn't even say they were sorry. In these situations, it's easy to think "*meh, could have been a fluke event*". So I took a closer look and found violations by the same participants which made it much harder to argue their case of sheer negligence. Here are a couple for AMRO:

Disclosure 39 of 78

Reporting Source:	Regulator
Current Status:	Final
Allegations:	CFTC RELEASE PR6614-13/JUNE 19, 2013: THE COMMODITY FUTURES TRADING COMMISSION (CFTC) HAS REASON TO BELIEVE THAT ABN AMRO CLEARING CHICAGO LLC VIOLATED THE COMMODITY EXCHANGE ACT (THE CEA) AND COMMISSION REGULATIONS (REGULATIONS). THEREFORE, THE COMMISSION DEEMS IT APPROPRIATE AND IN THE PUBLIC INTEREST THAT PUBLIC ADMINISTRATIVE PROCEEDINGS BE, AND HEREBY ARE, INSTITUTED TO DETERMINE WHETHER THE FIRM HAS ENGAGED IN THE VIOLATIONS AS SET FORTH HEREIN AND TO DETERMINE WHETHER ANY ORDER SHOULD BE ISSUED IMPOSING REMEDIAL SANCTIONS. THE CFTC

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ISSUED AN ORDER FILING AND SETTLING CHARGES AGAINST THE FIRM FOR FAILING TO SEGREGATE OR SECURE SUFFICIENT CUSTOMER FUNDS, FAILING TO MEET THE MINIMUM NET CAPITAL REQUIREMENTS, FAILURE TO MAINTAIN ACCURATE BOOKS AND RECORDS, AND FAILURE TO SUPERVISE ITS EMPLOYEES.

ABN AMRO got slapped with a \$1,000,000 fine for understating capital requirements, failing to maintain accurate books, and failing to supervise employees. If you mess up once or twice but end up fixing the problem- GREAT. When your primary business is to clear trades and you fail THIS bad, there is a much bigger problem going on. It gets hard to defend this as an accident when every stage of the trade recording process is fundamentally flawed. The following screenshot came from the same violation:

THE CME GROUP FOUND THAT THE FIRM HAD IMPROPERLY USED A CUSTOMER'S WITHDRAWN WAREHOUSE RECEIPTS AS COLLATERAL FOR MARGINING PURPOSES. WITHOUT THESE WAREHOUSE RECEIPTS, THE CUSTOMER'S ACCOUNTS WERE UNDER-MARGINED ON SEVERAL OCCASIONS, AND THE FIRM HAD TO REDUCE ITS ADJUSTED NET CAPITAL BY AN AMOUNT EQUAL TO THE MARGIN DEFICITS. ONCE THESE

[Warehouse receipts](#) are like the receipts you get after buying lumber online. You can print these out and take them to Home-Depot, where you exchange them for the ACTUAL lumber in the store. Instead of trading the actual goods, you can trade a warehouse receipt instead... so yeah... since this ONE record allowed AMRO to meet their customer's margin requirement, it seems EXTREMELY suspicious that they didn't appropriately remove it once they were withdrawn.

Do I think this was an accident? F*ck no. Because FINRA reported them 8 years later for doing the SAME F*CKING THING:

Disclosure 4 of 78

Reporting Source: Regulator

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Current Status: Final

Allegations: WITHOUT ADMITTING OR DENYING THE FINDINGS, THE FIRM CONSENTED TO THE SANCTIONS AND TO THE ENTRY OF FINDINGS THAT IT UNDERSTATED THE PORTFOLIO MARGIN REQUIREMENTS FOR ACCOUNTS AT VARIOUS POINTS IN TIME. THE FINDINGS STATED THAT THE FIRM INCORRECTLY TREATED CERTAIN OTC EQUITY SECURITIES THAT ARE NOT MARGIN ELIGIBLE, AS MARGINABLE SECURITIES. AS A CONSEQUENCE, THE FIRM UNDERSTATED THE MARGIN REQUIREMENTS FOR THESE ACCOUNTS BY MILLIONS OF DOLLARS. THE FIRM MISTAKENLY CATEGORIZED THE OTC TRADED EQUITIES AT ISSUE AS MARGIN ELIGIBLE BECAUSE OF AN INCORRECT DEFINITION OF MARGIN ELIGIBLE SECURITIES USED BY THE FIRM. AFTER THE PROBLEM WAS IDENTIFIED BY FINRA, THE FIRM CORRECTED THE ISSUE.

Once again, AMRO got caught understating their margin requirements. Last time, they used the value of withdrawn warehouse receipts to meet their margin requirements. Here, they're using securities which weren't eligible for margin to meet their margin requirements.

You can paint apple orange, but it's still an apple. The bullsh*t I read about in these reports doesn't really shock me anymore. It's actually the opposite.. You begin to *expect* bigger fines as they set higher benchmarks for misconduct. When I find a case like AMRO, I'll usually put more time into it because certain citations represent puzzle pieces. Once you find enough pieces, you can see the bigger picture. So believe me when I say I was genuinely shocked by the [detail report](#) on this case...

OVERVIEW

From April 2007 until July 2015 (the “relevant period”), AACC understated the portfolio margin requirements for 22 accounts at various points in time. It incorrectly treated certain over-the-counter (“OTC”) equity securities, which are not margin eligible, as marginable securities. As a consequence, the firm understated the margin requirements

This has been going on for 8 F*CKING YEARS!?

Without a doubt, this is a great example of a violation where the misconduct supposedly *ended* in 2015 but took another 4 years for FINRA to publish the d*mn report. If my math is correct, the 8 year “relevant period” plus the 4 years FINRA spent... I don't know... reviewing?... yields a total of 12 years. In other words, from the time this problem started to the time it was publicized by FINRA, the kids in 1st grade had graduated high school...

Does anyone else think these self-regulatory organizations (SROs) are doing a terrible job self-regulating? How can we trust these situations are appropriately monitored if it takes 12 years for a sh*t blossom to bloom?

...OH! I almost forgot... After understating their margin requirements in 22 accounts for over 8 years, ABN AMRO paid a \$150,000 fine to settle the dust...

I know that was a sh*t load of information so let me summarize it for you:

One of the most common citations occurs when a firm “accidentally” marks a short sale as long, or misreports short interest positions to FINRA. When a short sale occurs, that transaction should be marked with a short sale indicator. Despite this, many participants do it to avoid the borrow requirements set by Regulation SHO. If they mark a short sale as long, they are not required to locate a borrow because FINRA doesn't know it's a short sale. This is why so many of these FINRA violations include a statement about the broker failing to locate a borrow along with the failure to mark a short sale indicator on the transaction. It literally means the broker was naked short selling a stock and telling FINRA they physically owned that share..

Suddenly, a “small” violation had much bigger implications. The number of short shares that have been excluded from the short interest calculation is directly related to these violations... and there are HUNDREDS of them. Who knows how many companies have under reported short interest positions..

To be clear, I did NOT choose them based on the amount of ‘dirt’ they had. AMRO's violations were like grains of sand on a beach and It's going to take A LOT of dirt to fill the bottomless pit that is Ken Griffin's soul. Frankly, ABN AMRO wouldn't get us there with 10,000 FINRA violations. So without further ado, let's get dirty..

Section 3: Call em' out...

When FINRA publishes one of their reports, the granular details like numbers and dates are often left out. This makes it impossible to determine how systematic a particular issue might be.

For example, if you know that “XYZ failed to comply with FINRA’s short interest reporting requirements” your only conclusion is that the violation occurred. However, if you know that “XYZ failed to comply with FINRA’s short interest reporting requirements on 15,000 transactions during 2020” you can start investigating the magnitude of that violation. If XYZ only completed 100,000 transactions in 2020, it means 15% of their transactions failed to meet requirements. This represents a major systematic risk to XYZ and the parties it conducts business with.

I spent some time analyzing [Apex Clearing Corporation](#) after I left ABN AMRO. Apex is 8th on the list and the 2nd participant I found with an evident short selling problem.

In 2019, FINRA initiated a case against Apex for doing the same sh*t as ABN AMRO. However, the magnitude of this violation really put things into perspective: I got a small taste of how f*cked this house of cards truly is..

Disclosure 2 of 44

Reporting Source: Regulator

Current Status: Final

Allegations: WITHOUT ADMITTING OR DENYING THE FINDINGS, THE FIRM CONSENTED TO THE SANCTIONS AND TO THE ENTRY OF FINDINGS THAT IT FAILED TO COMPLY WITH FINRA'S SHORT INTEREST REPORTING REQUIREMENTS AND RELATED SUPERVISION OBLIGATIONS. THE FINDINGS STATED THAT THE FIRM EXPERIENCED AN ISSUE IN ITS SHORT INTEREST REPORTING LOGIC THAT EXCLUDED CERTAIN SHORT INTEREST POSITIONS FROM THE FIRM'S SUBMISSIONS TO FINRA. THE FINDINGS ALSO STATED THAT THE FIRM'S SUPERVISORY SYSTEM WAS NOT REASONABLY DESIGNED TO ACHIEVE COMPLIANCE WITH ITS SHORT INTEREST REPORTING OBLIGATIONS. SPECIFICALLY, THE FIRM FAILED TO ESTABLISH AND MAINTAIN A SUPERVISORY SYSTEM, INCLUDING WSPS, TO CONFIRM THAT ITS REPORTING SYSTEM CAPTURED ALL REPORTABLE SHORT INTEREST POSITIONS. MOREOVER, THE FIRM DID NOT HAVE A SUPERVISORY SYSTEM TO REVIEW FOR THE ACCURACY OF THE FIRM'S SHORT INTEREST POSITIONS REPORTED TO FINRA.

Initiated By: FINRA

Date Initiated: 10/15/2019

Docket/Case Number: [2016049448301](#)

This is practically a template of the first ABN AMRO violation we discussed. To see the difference, we need to look at their [letter of Acceptance, Waiver and Consent](#) (AWC)..

FACTS AND VIOLATIVE CONDUCT

Short Interest Reporting Violations

1. FINRA Rule 4560 requires firms to maintain a record of total short positions in all customer and proprietary firm accounts in all equities securities (with certain exceptions that are not applicable here), and regularly report such information to FINRA in such a manner as may be prescribed by FINRA.
2. During the review period, the firm experienced an issue in its short interest reporting logic that excluded certain short interest positions from the firm's submissions to FINRA. Specifically, Apex instructed its correspondent broker-dealer customers to book short positions into either the Type 1 (cash) or Type 5 (short margin) accounts. Unbeknownst to Apex, certain correspondent broker-dealers were booking short positions into another account available to them – Type 2 (margin) account. The short positions booked into this account were not included in the firm's submissions to FINRA. For two sample settlement dates during the 47-months review period the firm failed to report 256 short interest positions totaling 481,195 shares, and inaccurately reported 130 short interest positions totaling 1,648,923 shares, when it should have reported 130 short interest positions totaling 2,528,244 shares.
3. By virtue of the foregoing, the firm violated FINRA Rules 4560 and 2010.¹

Let's break this down step-by-step...

Apex had an issue for 47 months where certain customers recorded their short positions in an account which was NOT being sent to FINRA. It only takes a few wrinkles on the brain to realize this is a problem. The sample data tells us just how bad that problem is..

When you see the term “*settlement days*”, think “T+2”. Apex follows the T+2 settlement period for both cash accounts and margin accounts which means the trade *should* clear 2 days after the original trade date. When you buy stock on a Monday, it should settle by Wednesday. Ok.. quick maff...

There are roughly 252 trading days in one year after removing weekends and holidays. Throughout the 47 month “review period”, we can safely assume that **Apex had roughly 987** $((252/ 12) * 47)$ **settlement dates**...

In other words: 256 misstated reports over 47 months is more than 1 misstatement / week for nearly 4 years. Tell me again how this is *trivial*?

The wording of the “sample settlement” section is a bit ambiguous... It doesn't clarify if those were the only 2 settlement dates they sampled, or if they were the only settlement dates with reportable issues. Honestly, I would be shocked if it was the latter because auditors don't examine every record, but I can't be certain...

Anyway... FINRA discovered 256 short interest positions, consisting of 481,195 shares, were *incorrectly* excluded from their short interest report. In addition, they understated the share count by 879,321 in 130 separate short interest positions. Together, this makes 1,360,516 shares that were excluded from the short interest calculation. When you realize nearly 1.5 million 'excluded' shares were discovered in just 2 settlement periods and there were almost 1,000 dates to choose from, it seriously dilates the imagination... Once again... FINRA wiped the slate clean for just \$140,000...

I want to talk about one last thing before we jump to the next section. Did you happen to notice the different account types that Apex discussed in their [letter of Acceptance, Waiver and Consent](#) ? They specifically instructed their customers to book short positions into a TYPE 1 (CASH) account, or TYPE 5 (SHORT MARGIN) account. A short margin account is just a margin account that holds short positions. The margin requirement for short positions are more strict than regular margin accounts, so I can see the advantage in separating them.

In the [AMA with Wes Christian](#) (*starting at 7:30*), he specifically discussed how a broker-dealer's margin account is used to locate shares for short sellers. However, the margin account contains shares that were previously pledged to another party. Given the lack of oversight in securities lending, the problem keeps compounding each time a new borrower claims ownership of that share.

Now think back to the situation with Apex..

They asked their customers to book short positions to a short-margin account or a cash account. The user agreement with a margin account allows Apex to continue lending those securities at any time. As discussed with Dr. T and Carl Hagberg, the broker collects interest for lending your margin shares and doesn't pay you anything in return. When multiple locates are authorized for the same share, the broker collects multiple lending fees on the same share. In contrast, the cash account falls under the protection of [SEA 15c3-3](#) and consists of shares that have not been leveraged- or lent- like the margin-short account. According to Wes (*starting at 8:30*), these shares are segregated and cannot be touched. The broker cannot encumber-or restrict- them in any way. However, according to Wes, this is currently happening. He also explained how Canada has legalized this and currently allows broker-dealers to short sell your cash account shares against you.

Alright.... I'll stop beating the dead horse regarding short sale indicators & inaccurate submissions of short interest positions. Given the volume of citations we haven't discussed, I'll summarize some of my findings, below.

Keep in mind these are ONLY for "**FAILURE TO REPORT SHORT INTEREST POSITIONS**" or "**FAILURE TO INDICATE A SHORT SALE MODIFIER**". If the violations contain additional information, it's because that citation actually listed additional information. **It does NOT represent an all-inclusive list of short selling violations for these participants.**

...You wanted to know how systematic this problem is, so here you go... (*EACH BROKER-DEALER NAME IS HYPERLINKED TO THEIR FINRA REPORT*)

1. [Barclays](#) | Disclosure 36 – "SUBMITTED 86 SHORT INTEREST POSITIONS TOTALING 41,100,154 SHARES WHEN THE ACTUAL SHORT INTEREST POSITION WAS 44,535,151 SHARES.. FAILED TO REPORT 8 SHORT INTEREST POSITIONS TOTALING 1,110,420 SHARES"
 - A. \$10,000 FINE
2. [Barclays](#) | Disclosure 54 – "SUBMITTED AN INACCURATE SHORT INTEREST POSITION TO FINRA AND FAILED TO REPORT ITS SHORT INTEREST POSITIONS IN 835 POSITIONS TOTALING 87,562,328 SHARES"

- A. \$155,000 FINE
- 3. [BMO Capital Markets Corp](#) | Disclosure 23 – “SUBMITTED SHORT INTEREST POSITIONS TO FINRA THAT WERE INCORRECT AND FAILED TO REPORT TO FINRA ITS SHORT INTEREST POSITIONS TOTALING OVER 72 MILLION SHARES FOR 11 MONTHS”
 - A. \$90,000 FINE
- 4. [BNP Paribas Securities Corp](#) | Disclosure 53 – “FAILED TO REPORT TO FINRA ITS SHORT INTEREST IN 2,509 POSITIONS TOTALING 6,051,974 SHARES”
 - A. \$30,000 FINE
- 5. [BNP Paribas Securities Corp](#) | Disclosure 9 – “ON 35 OCCASIONS OVER A FOUR-MONTH PERIOD, A HEDGE FUND SUBMITTED SALE ORDERS MARKED “LONG” TO BNP FOR CLEARING. FOR EACH OF THOSE “LONG” SALES, ON THE MORNING OF SETTLEMENT, THE HEDGE FUND DID NOT HAVE THE SHARES IN IT’S BNP ACCOUNT TO COVER THE SALE ORDER. IN ADDITION, BNP WAS ROUTINELY NOTIFIED THAT THE HEDGE FUND WOULD NOT BE ABLE TO COVER. NEVERTHELESS, WHEN EACH SETTLEMENT DATE ARRIVED AND THE HEDGE FUND WAS UNABLE TO COVER, BNP LOANED THE SHARES TO THE HEDGE FUND. IN TOTAL, BNP LOANED MORE THAN 8,000,000 SHARES TO COVER THESE PURPORTED “LONG” SALES”
 - A. \$250,000 FINE
- 6. [Cantor Fitzgerald & Co](#) | Disclosure 1 - (literally came out on 5/6/2021) – “THE FIRM SUBMITTED INACCURATE SHORT INTEREST POSITIONS TO FINRA. THE FIRM OVERREPORTED NEARLY [55,000,000 SHORT SHARES](#) WHICH WERE CUSTODIED WITH AND ALREADY REPORTED BY ITS CLEARING FIRM, WITH WHICH CANTOR MAINTAINS A FULLY DISCLOSED CLEARING AGREEMENT”
 - A. \$250,000 FINE
- 7. [Cantor Fitzgerald & Co](#) | Disclosure 31 - “...THE FIRM EXECUTED NUMEROUS SHORT SALE ORDERS AND FAILED TO PROPERLY MARK THE ORDERS AS SHORT... THE FIRM, ON NUMEROUS OCCASIONS, ACCEPTED SHORT SALE ORDERS IN AN EQUITY SECURITY FROM ANOTHER PERSON, OR EFFECTED A SHORT SALE FROM ITS OWN ACCOUNT WITHOUT BORROWING THE SECURITY...”
 - A. \$53,500 FINE
- 8. [Cantor Fitzgerald & Co](#) | Disclosure 33 - “...EXECUTED SHORT SALE ORDERS AND FAILED TO PROPERLY MARK THE ORDERS AS SHORT. THE FIRM HAD FAIL-TO-DELIVER POSITIONS AT A REGISTERED CLEARING AGENCY IN THRESHOLD SECURITIES FOR 13 CONSECUTIVE SETTLEMENT DAYS... FAILED TO IMMEDIATELY CLOSE OUT FTD POSITIONS... ACCEPTED SHORT SALE ORDERS FROM ANOTHER PERSON, OR EFFECTED A SHORT SALE FROM ITS OWN ACCOUNT, WITHOUT BORROWING THE SECURITY OR HAVING REASONABLE GROUNDS TO BELIEVE THAT THE SECURITY COULD BE BORROWED...”
 - A. \$125,000 FINE
- 9. [Canaccord Genuity Corp](#) | Disclosure 17 - “THE FIRM EXECUTED SALE TRANSACTIONS AND FAILED TO REPORT EACH OF THESE TRANSACTIONS TO THE FINRA/NASDAQ TRADE REPORTING FACILITY AS SHORT”
 - A. \$57,500 FINE
- 10. [Canaccord Genuity Corp](#) | Disclosure 20 - “THE FIRM EXECUTED SHORT SALE ORDERS AND FAILED TO PROPERLY MARK THE ORDERS AS SHORT”
 - A. \$27,500 FINE
- 11. [Canaccord Genuity Corp](#) | Disclosure 31 - “...SUBMITTED TO NASD MONTHLY SHORT INTEREST POSITION REPORTS THAT WERE INACCURATE”
 - A. \$85,000 FINE
- 12. Citadel Securities LLC | [Citadel Has No Clothes](#) – LITERALLY ALL I TALK ABOUT IN THAT POST. GO READ IT

13. [Citigroup Global Markets](#) | Disclosure 10 – “THE FIRMS TRADING PLATFORM FAILED TO RECOGNIZE THAT THE FIRM WAS SELLING SHORT WHEN IT WAS ACTING AS THE CONTRA PARTY TO A CUSTOMER TRADE. AS A RESULT, THE FIRM ERRONEOUSLY REPORTED SHORT SALES TO A FINRA TRADE REPORTING FACILITY AS LONG SALES... EFFECTING SHORT SALES FROM ITS OWN ACCOUNT WITHOUT BORROWING THE SECURITY...”
A. \$225,000 FINE
14. [Citigroup Global Markets](#) | Disclosure 59 – “...THE FIRM RECORDED 203,653 SHORT SALE EXECUTIONS ON ITS BOOKS AND RECORDS AS LONG SALES, SUBMITTED INACCURATE ORDER ORIGINATION CODES AND ACCOUNT TYPE CODES TO THE AUDIT TRAIL SYSTEM FOR APPROXIMATELY 2,775,338 ORDERS... “
A. \$300,000 FINE
15. [Citigroup Global Markets](#) | Disclosure 76 – “...FAILED TO PROPERLY MARK APPROXIMATELY 9,717,875 SALE ORDERS AS SHORT SALES... FINDINGS ALSO ESTIMATED THAT THE FIRM ENTERED **55 MILLION ORDERS** INTO THE NASDAQ MARKET CENTER THAT IT FAILED TO CORRECTLY INDICATE AS SHORT SALES...”
A. \$2,250,000 FINE
16. [Cowen and Company LLC](#) | Several Disclosures – almost every other disclosure is for failing to mark a sale with the appropriate indicator, including short AND long sale indicators
17. [Credit Suisse Securities LLC](#) | Disclosure 34 – “NEW ORDER REPORTS WERE INACCURATELY ENTERED INTO ORDER AUDIT TRAIL SYSTEM (OATS) AS LONG SALES BUT WERE TRADE REPORTED WITH A SHORT SALE INDICATOR”
A. \$50,000 FINE
18. [Credit Suisse Securities LLC](#) | Disclosure 95 – “BETWEEN SEPTEMBER 2006 AND JUNE 2008, CREDIT SUISSE FAILED TO SUBMIT ACCURATE PERIODIC REPORTS WITH RESPECT TO SHORT POSITIONS...”
A. \$40,000 FINE
19. [Deutsche Bank Securities INC.](#) | Disclosure 50 – “THE FIRM FAILED TO REPORT SHORT INTEREST POSITIONS IN DUALY-LISTED SECURITIES”
A. \$200,000 FINE
20. [Deutsche Bank Securities INC.](#) | Disclosure 52 – “THE FIRM... EXPERIENCED MULTIPLE PROBLEMS WITH ITS BLUE SHEET SYSTEM THAT CAUSED IT TO SUBMIT INACCURATE BLUE SHEETS TO THE SEC AND FINRA... INCORRECTLY REPORTED LONG ON ITS BLUE SHEET TRANSACTIONS WHEN CERTAIN TRANSACTIONS SHOULD HAVE BEEN MARKED SHORT”
A. \$6,000,000 FINE (SEVERAL OTHER ISSUES REPORTED IN ADDITION TO SHORTS)
21. [Deutsche Bank Securities INC.](#) | Disclosure 58 – “BETWEEN JANUARY 2005 AND CONTINUING THROUGH NOVEMBER 2015, THE FIRM IMPROPERLY INCLUDED THE AGGREGATION OF NET POSITIONS IN CERTAIN SECURITIES OF A NON-US BROKER AFFILIATE... IN ADDITION... DURING THE PERIOD BETWEEN APRIL 2004 AND SEPTEMBER 2012, THE FIRM INAPPROPRIATELY REPORTED CERTAIN SHORT INTEREST POSITIONS ON A NET, INSTEAD OF GROSS, BASIS..”
A. \$1,400,000 FINE
22. [Goldman Sachs & Co. LLC](#) | Disclosure 32 – “THE FIRM REPORTED SHORT SALE TRANSACTIONS TO FINRA TRADE REPORTING FACILITY WITHOUT THE REQUIRED SHORT SALE MODIFIER”
A. \$260,000 FINE (SEVERAL OTHER ISSUES REPORTED IN ADDITION TO SHORTS)
23. [Goldman Sachs & Co. LLC](#) | Disclosure 54 – “FAILED TO ACCURATELY APPEND THE SHORT SALE INDICATOR TO FINRA/NASDAQ TRADE REPORTING FACILITY REPORTS... INACCURATELY MARKED SELL TRANSACTIONS ON ITS TRADING LEDGER”
A. \$55,000 FINE

24. [Goldman Sachs & Co. LLC](#) | Disclosure 63 – “...SUBMITTED TO FINRA AND THE SEC BLUE SHEETS THAT INACCURATELY REPORTED CERTAIN SHORT SALE TRANSACTIONS AS LONG SALE TRANSACTIONS WITH RESPECT TO THE FIRM SIDE OF CUSTOMER FACILITATION TRADES... THE FIRM REPORTED SHORT SALES AS LONG SALES ON ITS BLUE SHEETS WHEN THE TRADING DESK USED A PARTICULAR MIDDLE OFFICE SYSTEM...”
 - A. \$1,000,000 FINE
 25. [Goldman Sachs & Co. LLC](#) | Disclosure 150 – “GOLDMAN SACHS & CO. FAILED TO REPORT SHORT INTEREST POSITIONS FOR FOREIGN SECURITIES AND NUMEROUS SHARES ONE MONTH... THE FIRM REPORTED SHORT INTEREST POSITIONS IN SECURITIES TOTALING SEVERAL MILLION SHARES EACH TIME WHEN THE ACTUAL SHORT INTEREST POSITIONS IN THE SECURITIES WERE ZERO SHARES... ACCEPTING A SHORT SALE ORDER IN AN EQUITY SECURITY FROM ANOTHER PERSON, OR EFFECTED A SHORT SALE FROM ITS OWN ACCOUNT, WITHOUT BORROWING THE SECURITY OR BELIEVING THE SECURITY COULD BE BORROWED ON THE DATE OF DELIVERY...”
 - A. \$120,000 FINE
 26. [Goldman Sachs & Co. LLC](#) | Disclosure 167 – “...THE FIRM FAILED TO REPORT TO THE NMC THE CORRECT SYMBOL INDICATING THAT THE TRANSACTION WAS A SHORT SALE FOR TRANSACTIONS IN REPORTABLE SECURITIES...”
 - A. \$600,000 FINE (SEVERAL OTHER ISSUES REPORTED IN ADDITION TO SHORTS)
 27. [HSBC Securities \(USA\) INC.](#) | Disclosure 26 – “FIRM EXECUTED SHORT SALE TRANSACTIONS AND FAILED TO MARK THEM AS SHORT... HSBC SECURITIES HAD A FAIL-TO-DELIVER SECURITY FOR 13 CONSECUTIVE SETTLEMENT DAYS AND FAILED TO IMMEDIATELY CLOSE OUT THE FTD POSITION... THE FIRM CONTINUED TO HAVE A FTD IN THE SECURITY AT A CLEARING AGENCY ON 79 ADDITIONAL SETTLEMENT DAYS...”
 - A. \$65,000 FINE
-

I'm going to stop at 'H' because I'm tired of writing. Hopefully, you all understand the point so far. We're only 8 letters into the alphabet and have successfully buried Ken to his waist. The system that is used to mark the proper transaction type (sell, buy, short sell, short sell exempt, etc.) is obviously broken... There, I said it.. the system is INDUBITABLY, UNDOUBTEDLY, INEVITABLY F*CKED.

Regardless of the cause- fraud or negligence- there are too many firms failing to accomplish a seemingly simple task. The consequences of which are creating far more shares than we can imagine. It's a gigantic domino effect. If you fail to properly mark 1,000,000 short shares and a year goes by without catching the problem, it's already too late. They're like the f*cking replicators from Stargate.

In each of the examples listed above, the short interest on the stock was understated by the number of shares excluded... and that was just a handful.

Knowing this, how can someone look at the evidence and say it's *trivial*....?

No one really knows HOW systematic this issue is because it is so deeply incorporated in the market that it has BECOME the system itself. Therefore, there is obviously something much deeper going on, here.. How does one argue against the severity of these problems after reading this? There are FAR too many things that don't make sense and FAR too many people turning a blind eye..

The only conclusion I keep coming back to is that the people with money know what's going on and are desperately trying to keep it under wraps..

So.... In an effort to prove this, I looked for violations that showed their desperation to protect this f*cked up system.

Buckle up.

Part III

Section 4: Slimy...

If you watched the [AMA with Wes Christian](#), he talks about the number of occurrences where the actual short interest is severely understated based on the data his firm obtained for legal proceedings. According to his numbers, in most cases the short interest is 50% - 150% **MORE** than what is reported by the SEC (*starting at 14:30*).

The objective isn't to address the issue: it's to keep the issue hidden. Firms that underreport their short interest are gaming the system by taking advantage of how the short interest calculation is done. When the SEC relies on reports that broker-dealers provide, and FINRA takes YEARS to reveal the lies within those reports, the broker-dealer can lie without immediately facing the consequences. It allows these firms to operate in a high-risk environment without exposing just HOW big their risk-appetite is. Another example that Wes mentioned was [Merrill Lynch](#). Merrill was fined [\\$415,000,000](#) (*violation 3*) in 2016 for using securities held in their customer's accounts to cover their own trades. Check out this screenshot I took from that case:

Allegations:	ON JUNE 23, 2016, THE SECURITIES AND EXCHANGE COMMISSION ("SEC") ISSUED AN ADMINISTRATIVE ORDER IN WHICH IT FOUND THAT MERRILL LYNCH, PIERCE, FENNER & SMITH INCORPORATED ("MERRILL LYNCH") AND MERRILL LYNCH PROFESSIONAL CLEARING CORP. ("MLPRO") (COLLECTIVELY, "ML") HAD WILLFULLY VIOLATED SECTION 15(C)(3) OF THE SECURITIES EXCHANGE ACT OF 1934 ("EXCHANGE ACT") AND RULE 15C3-3 THEREUNDER AND SECTION 17(A)(1) OF THE EXCHANGE ACT AND RULES 17A-3(A)(10) AND 17A-5(A) THEREUNDER, AND THAT MERRILL LYNCH WILLFULLY VIOLATED SECTION 17(A)(1) OF THE EXCHANGE ACT AND RULES 17A-5(D)(3) (AS IT EXISTED PRIOR TO AMENDMENTS TO RULE 17A-5 IN 2014), 17A-5(D)(2)(II), 17A-5(D)(3) AND 17A-11(E) THEREUNDER, AND EXCHANGE ACT RULE 21F-17. SPECIFICALLY, THE ORDER FOUND THAT (I) ML ENGAGED IN A SERIES OF COMPLEX TRADES THAT ALLOWED IT TO USE CUSTOMER CASH TO FINANCE FIRM INVENTORY AND (II) MERRILL LYNCH ALLOWED CERTAIN OF ITS CLEARING BANKS TO HOLD LIENS ON CUSTOMER SECURITIES.
Initiated By:	UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Date Initiated:	06/23/2016
Docket/Case Number:	3-17312

Remember when we mentioned [SEA 15c3-3](#) in the case with Apex? They were asking customers to book short positions to either a cash account or a short margin account. [SEA 15c3-3](#) protects those customers from allowing brokers to lend out the securities within their cash accounts...

Well Merrill Lynch knocked that one right out of the f*cking park.

COUNTERPARTY ENTITIES. THROUGH THESE TRADES, ML IMPROPERLY REDUCED BY BILLIONS OF DOLLARS THE AMOUNT IT WAS REQUIRED TO DEPOSIT IN ITS CUSTOMER RESERVE ACCOUNT. THESE TRADES EVOLVED OVER TIME AND, IN THEIR FINAL ITERATION, BECAME INSTANTANEOUS ROUNDTRIPS STRUCTURED TO PROVIDE FINANCING FOR ML'S ACTIVITIES RATHER THAN IN RESPONSE TO CUSTOMER TRADING OBJECTIVES. RESPONDENT USED THESE TRADES TO REMOVE UP TO \$5 BILLION OF CUSTOMER CASH WEEK OVER WEEK FROM ITS CUSTOMER RESERVE ACCOUNT. ML THEN USED THESE FUNDS TO FINANCE ITS BUSINESS ACTIVITIES. HAD ML FAILED WHEN THE TRADES WERE IN USE, ITS CUSTOMERS WOULD HAVE BEEN EXPOSED TO A SHORTFALL OF CUSTOMER CASH IN THE CUSTOMER RESERVE ACCOUNT. THE SIGNIFICANT PENALTIES AND OTHER RELIEF IMPOSED IN THIS ORDER IN CONNECTION WITH ML'S VIOLATIONS OF THE CUSTOMER PROTECTION RULE REFLECT THE SERIOUSNESS WITH WHICH THE COMMISSION VIEWS FAILURES TO COMPLY WITH THIS RULE. AS A RESULT OF THE CONDUCT, MLPRO WILLFULLY VIOLATED SECTION 15(C)(3) OF THE EXCHANGE ACT AND RULE 15C3-3 THEREUNDER. ALSO, MLPRO WILLFULLY VIOLATED SECTION 17(A)(1) OF THE EXCHANGE ACT AND RULES 17A-3(A)(10), AND 17A-5(A).

Initiated By: UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Merrill made it seem like the required deposit in their customer reserve account was much lower than it truly was. They wouldn't have been able to use that cash if it reduced the amount below the minimum capital requirement, so they found a way to fudge the numbers. In doing so, they managed to prevent a CODE RED while reaping the benefits of a high-risk 'opportunity'. Should Merrill have filed bankruptcy during that time, those customers would have been completely blindsided.

In the case of short selling, the *true* exposure of short interest is unknown... and I'm not just talking about the short sale indicator. When a firm fails to deliver securities that were sold short, there's a pretty good indication that they've exposed themselves to a bit of a problem.. Now imagine a case where the FTDs start piling up and they STILL continue to short sell that same security.. think I'm joking?

Check out the [Royal Bank of Canada](#)

Disclosure 63 of 332

Reporting Source: Regulator
Current Status: Final
Allegations: RBC CAPITAL MARKETS, LLC ("RBC"), AN EXCHANGE TPH ORGANIZATION, WAS CENSURED AND FINED \$75,000 FOR: (I) FAILING TO PROPERLY CLOSE OUT A FAIL-TO-DELIVER POSITION IN SEVEN SAMPLED SECURITIES, INCLUDING SANOMEDICS INTERNATIONAL HOLDINGS INC. ("SIMH"), APPLIED DNA SCIENCES INC. ("APDN"), GREAT ATLANTIC AND PACIFIC TEA CO. INC. ("GAPTQ"), QUAMTEL INC. ("QUMI"), TITAN IRON ORE CORP. ("TFER"), JINKOSOLAR HOLDING CO., LTD. ("JKS"), AND ITT EDUCATIONAL SERVICES, INC. ("ESI"); (II) INCREASING ITS SHORT POSITION WHEN A FAIL-TO-DELIVER POSITION HAD NOT BEEN PROPERLY CLOSED OUT WITHOUT DEMONSTRATING THAT IT MADE ARRANGEMENTS FOR PRE-BORROWING IN THE FOLLOWING EQUITY SECURITIES: APDN, QUMI, TFER, GAPTQ, AND JKS; AND (III) FAILING TO SUPERVISE ITS ASSOCIATED PERSONS TO ASSURE COMPLIANCE WITH REGULATION SHO RULE 204 AS: (1) RBC FAILED TO ASSURE THAT NUMEROUS FAIL-TO-DELIVER POSITIONS WERE CLOSED OUT ON A TIMELY BASIS; AND (2) RBC IMPROPERLY ASSERTED

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RELIANCE ON CERTAIN EXEMPTIONS UNDER REG. SHO RULE 204 WITHOUT UNDERTAKING SUFFICIENT DUE DILIGENCE TO ASCERTAIN AND DOCUMENT THAT SPECIFIC REQUIREMENTS THEREUNDER WERE MET. (EXCHANGE RULE 4.2 - ADHERENCE TO LAW; AND REGULATION SHO RULE 204 - CLOSE-OUT REQUIREMENT, PROMULGATED UNDER THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED)

Initiated By: CHICAGO BOARD OPTIONS EXCHANGE
Date Initiated: 11/11/2015
Docket/Case Number: 15-0093/ 20150459684
Principal Product Type: Options

Again... I was pretty shocked at that one. However, nothing rang-the-bell quite like this one from [Goldman Sachs](#):

Disclosure 30 of 148

Reporting Source: Regulator
Current Status: Final
Allegations: **04/26/2010**STIPULATION OF FACTS AND CONSENT TO PENALTY FILED BY NYSE REGULATION'S DIVISION OF ENFORCEMENT AND PENDING. CONSENTED TO FINDINGS:FOR THE SOLE PURPOSE OF SETTLING THIS

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90

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User Guidance



DISCIPLINARY PROCEEDING, WITHOUT ADJUDICATION OF ANY ISSUES OF LAW OR FACT, AND WITHOUT ADMITTING OR DENYING ANY ALLEGATIONS OR FINDINGS REFERRED TO HEREIN, GOLDMAN SACHS EXECUTION & CLEARING, L.P.STIPULATED THAT DURING THE PERIOD OF SEPTEMBER 24, 2008 TO JANUARY 22, 2009, IT

1.VIOLATED RULE 204T(A) OF REGULATION SHO BY FAILING ON APPROXIMATELY 68 OCCASIONS TO TIMELY CLOSE OUT FAIL-TO-DELIVER POSITIONS IN CERTAIN EQUITY SECURITIES (DECEMBER 9, 2008-JANUARY 22, 2009).

2.VIOLATED RULE 204T(B) OF REGULATION SHO ON APPROXIMATELY 45 OCCASIONS BY ACCEPTING CERTAIN CUSTOMER SHORT SALE ORDERS IN EQUITY SECURITIES FOR WHICH IT HAD AN OPEN FAIL-TO-DELIVER POSITION WHILE GSEC AND THE CUSTOMER WERE IN THE "PENALTY BOX", AS THE CUSTOMER HAD NOT FIRST BORROWED SUCH SECURITIES OR ENTERED INTO A BONA-FIDE ARRANGEMENT TO BORROW THE SECURITIES(DECEMBER 9, 2008 -JANUARY 22, 2009).

3.VIOLATED RULE 204T(C) OF REGULATION SHO ON APPROXIMATELY 68 OCCASIONS BY FAILING TO TIMELY NOTIFY ITS CUSTOMERS THAT THE FIRM HAD AN OPEN FAIL-TO-DELIVER POSITION THAT HAD NOT BEEN CLOSED OUT IN ACCORDANCE WITH RULE 204T(A) (DECEMBER 9, 2008-JANUARY 22, 2009).

4.VIOLATED NYSE RULE 342 BY FAILING TO REASONABLY SUPERVISE AND IMPLEMENT ADEQUATE CONTROLS, INCLUDING A SEPARATE SYSTEM OF FOLLOW-UP AND REVIEW, REASONABLY DESIGNED TO ACHIEVE COMPLIANCE WITH RULE 204T OF REGULATION SHO, AS DESCRIBED ABOVE.

STIPULATED SANCTION: CENSURE AND A \$450,000 FINE. THE AMOUNT TO BE PAID TO NYSE REGULATION BY THE FIRM SHALL BE REDUCED BY THE AMOUNT PAID BY THE FIRM PURSUANT TO AN AGREEMENT TO PAY A CIVIL MONETARY PENALTY OF \$225,000 TO THE UNITED STATES TREASURY IN RELATED PROCEEDINGS INSTITUTED BY THE SECURITIES AND EXCHANGE COMMISSION.

Initiated By: NEW YORK STOCK EXCHANGE
Date Initiated: 04/26/2010
Docket/Case Number: HBD# 10-NYSE-11

Goldman had 68 occasions in 4 months where they didn't close a failure-to-deliver... In 45 occasions, they CONTINUED to accept customer short sale orders in securities which it had an active failure-to-deliver...

When a firm is really starting to sweat, they pull certain tricks out of their ass to quell the situation. Again, this is nothing but smoke and mirrors because that's all they can really do. Just as Merrill Lynch artificially lowered their customer reserve deposit, other firms make it look like they cover their short positions.

One of the ways they do this is by short selling a SH*T load of shares right before a buy-in... Since we're talking about Goldman Sachs, this seems like a great time to showcase their experience with this..

Disclosure 14 of 148

Reporting Source: Regulator

Current Status: Final

Allegations: WITHOUT ADMITTING OR DENYING THE FINDINGS, THE FIRM CONSENTED TO THE SANCTIONS AND TO THE ENTRY OF FINDINGS THAT IT DID NOT, AS A GENERAL PRACTICE, ALLOCATE RESPONSIBILITY FOR CLOSING OUT FAIL TO DELIVER POSITIONS TO ITS BROKER-DEALER CLIENTS UNDER REGULATION SHO RULES 203(B)(3)(VI), 204T(D), OR 204(D). THE FINDINGS STATED THAT THE FIRM'S SUPERVISORY POLICIES AND PROCEDURES FAILED TO ADDRESS THAT CERTAIN OPTIONS MARKET MAKER (OMM) CLIENTS OF THE FIRM HAD, ON A NUMBER OF OCCASIONS, SHORT SOLD A SECURITY ON THE SAME DAY THAT THEY WERE NOTIFIED THAT THEY WERE BEING "BOUGHT IN" BY THE FIRM IN THAT SAME SECURITY, TYPICALLY IN AMOUNTS EQUAL TO OR GREATER THAN THEIR ATTRIBUTED PORTION OF THE NUMBER OF SHARES PURCHASED BY THE FIRM IN AN EFFORT TO MEET ITS CLOSE-OUT OBLIGATIONS. THESE SHORT SALES WOULD OFFSET, IN WHOLE OR IN PART, THE EFFECT OF THE FIRM'S PURCHASES ON THE FIRM'S NET FAIL TO DELIVER POSITION IN THE NATIONAL SECURITIES CLEARING CORPORATION'S CONTINUOUS NET SETTLEMENT SYSTEM (CNS). THE FIRM FAILED TO IMPLEMENT ADEQUATE SUPERVISORY POLICIES AND PROCEDURES REASONABLY DESIGNED TO ADDRESS THE IMPACT OF OMM ACTIVITY ON THE CLOSE-OUT DATE ON THE FIRM'S NET FAIL TO DELIVER POSITION TO CNS BY REQUIRING THE FIRM TO ALLOCATE RESPONSIBILITY FOR THE CLOSE OUT TO ITS BROKER-DEALER CLIENTS OR BY TAKING OTHER APPROPRIATE STEPS TO DETERMINE WHETHER THE FIRM WAS A NET PURCHASER, OR NET FLAT OR NET LONG, AS APPLICABLE, ON THE CLOSE-OUT DATE. THE FIRM'S SUPERVISORY POLICIES AND PROCEDURES DID NOT PROVIDE FOR SUPERVISION REASONABLY DESIGNED TO ACHIEVE COMPLIANCE WITH THE APPLICABLE SECURITIES LAWS AND REGULATIONS, INCLUDING SEC AND FINRA RULES, REGARDING THE CLOSE-OUT OF FAIL TO DELIVER POSITIONS AS REQUIRED BY REGULATION SHO RULES 203(B)(3), 204T(A), AND 204(A).

I promise... It really is as dumb as it sounds...

So the perception here is when Goldman's client has a FTD and they find out a buy-in is coming, the required buy-in would obviously be too extreme for the client to handle.. So they begin to buy those shares while simultaneously shorting AT LEAST the same amount they were required to purchase...

Have you ever failed to repay a loan so you went to another bank and got a loan to cover the first one? Well that's exactly what this is... I know what you're probably thinking... "didn't that just kick the can down the road?". The answer is YES: it didn't actually solve anything.

There's still one more citation that Goldman received which truly represents the pinnacle of *no-sh\ts-given*. After I cover this, I don't know how anyone could argue the systematic risks that exist within the securities lending business.. Check it out:

Reporting Source: Regulator

Current Status: Final

Allegations: SEC ADMIN RELEASE 34-76899/JANUARY 14, 2016: THE SECURITIES AND EXCHANGE COMMISSION (COMMISSION) DEEMS IT APPROPRIATE AND IN THE PUBLIC INTEREST THAT PUBLIC ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS BE, AND HEREBY ARE, INSTITUTED PURSUANT TO SECTIONS 15(B) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934 (EXCHANGE ACT) AGAINST GOLDMAN, SACHS & CO. THESE PROCEEDINGS ARISE OUT OF PRACTICES ENGAGED IN BY GOLDMAN'S SECURITIES LENDING DEMAND TEAM (THE DEMAND TEAM), BETWEEN NOVEMBER 2008 AND MID-2013, IN PROVIDING AND DOCUMENTING "LOCATES" TO ENABLE ITS CUSTOMERS TO EXECUTE SHORT SALES. BETWEEN NOVEMBER 2008 AND MID-2013, TO COMPLY WITH REG SHO, GOLDMAN EMPLOYED A SYSTEM WHERE THE VAST MAJORITY OF CUSTOMER SHORT SALE LOCATE REQUESTS WERE HANDLED BY AN AUTOMATED MODEL THAT WOULD EITHER GRANT, IN WHOLE OR IN PART (OR FILL), DENY, OR ROUTE (OR PEND) THE REQUESTS FOR FURTHER REVIEW TO THE DEMAND TEAM, A GROUP OF TEN TO TWELVE INDIVIDUALS WHO WORKED ON GOLDMAN'S SECURITIES LENDING DESK. THE AUTOMATED MODEL WOULD REVIEW AND FILL LOCATE REQUESTS BASED ON CERTAIN AVAILABLE INVENTORY REPORTED TO GOLDMAN BY CERTAIN LENDING BANKS AND BROKERAGES THAT FED INTO GOLDMAN'S AUTOMATED MODEL AT THE START OF EACH DAY AFTER BEING REDUCED BY GOLDMAN BASED ON THEIR EXPERIENCE WITH VARIOUS LENDERS (THE START-OF-DAY INVENTORY). AS THE AUTOMATED MODEL PROCESSED LOCATE REQUESTS, IT REDUCED THAT START-OF-DAY INVENTORY ON A 1:1 BASIS FOR ALL SHARES THAT WERE USED TO GRANT LOCATE REQUESTS (REGARDLESS OF WHETHER THE CLIENT ACTUALLY USED THE LOCATE). WHEN THE START-OF-DAY INVENTORY WAS DEPLETED IN THAT MANNER, THE AUTOMATED MODEL WOULD PEND SUBSEQUENT LOCATE REQUESTS TO THE DEMAND TEAM FOR FURTHER REVIEW AND PROCESSING. OVER THE COURSE OF THE RELEVANT PERIOD, THE NUMBER OF LOCATE REQUESTS THAT PENDED TO THE DEMAND TEAM GREW SIGNIFICANTLY, REACHING MORE THAN 20,000 LOCATE REQUESTS PER DAY AT ITS PEAK. THE VOLUME OF LOCATE REQUESTS BECAME FAR MORE THAN THE DEMAND TEAM COULD MANUALLY HANDLE ON A REQUEST-BY-REQUEST BASIS. THUS, INSTEAD OF MANUALLY IDENTIFYING AN ALTERNATIVE SOURCE OF SECURITIES TO SATISFY THESE PENDED REQUESTS, THE DEMAND TEAM PROCESSED APPROXIMATELY 98 PERCENT OF THE PENDED REQUESTS BY RELYING ON A FUNCTION OF GOLDMAN'S ORDER MANAGEMENT SYSTEM REFERRED TO AS "FILL FROM AUTOLOCATE," WHICH WAS ACTIVATED BY THE "F3" KEY. THIS FUNCTION ENABLED THE DEMAND TEAM TO CAUSE GOLDMAN'S AUTOMATED MODEL TO FILL LOCATE REQUESTS BASED ON THE AMOUNT OF INVENTORY THAT

For 5 years, Goldman relied on a team of 10-12 individuals to locate shares to be used by its clients for short selling. This group was known as the "demand team". Naturally, as the number of requests coming in the door started to increase, it became difficult for the team to properly document all of them. The volume peaked at 20,000 requests PER DAY, but the number of individuals that handled this job stayed the same.

Obviously, this became too much for them to handle so they opted out of the manual process and found another solution- the F3 key....

Yes- the F3 key... This button activated an autofill system which completed **98% of Goldman's orders to locate shares**

EXISTED AT THE START OF THE DAY (I.E., THE START-OF-DAY INVENTORY LEVEL BEFORE ANY LOCATES WERE GRANTED), EVEN THOUGH GOLDMAN'S AUTOMATED MODEL HAD ALREADY TREATED THE START-OF-DAY INVENTORY AS DEPLETED. IN PROCESSING LOCATE REQUESTS USING THE "F3" FUNCTION, THE DEMAND TEAM TYPICALLY DID NOT CHECK ALTERNATIVE SOURCES OF SECURITIES OR PERFORM A MEANINGFUL FURTHER REVIEW. INSTEAD, THEY RELIED ON THEIR GENERAL BELIEF THAT GOLDMAN'S AUTOMATED MODEL WAS CONSERVATIVE AND THAT THE PROVISION OF ADDITIONAL LOCATES WOULD NOT RESULT IN FAILURES TO DELIVER THE SECURITIES IF AND WHEN DUE FOR SETTLEMENT. THE DEMAND TEAM DID NOT DOCUMENT THE BASIS FOR THIS GENERAL BELIEF. ADDITIONALLY, GOLDMAN'S DOCUMENTATION OF ITS COMPLIANCE WITH REG SHO IN ITS LOCATE LOG WAS INACCURATE IN THAT GOLDMAN FAILED TO SUFFICIENTLY DIFFERENTIATE BETWEEN LOCATES THAT WERE FILLED BY ITS AUTOMATED MODEL AND LOCATES THAT WERE FILLED BY THE DEMAND TEAM USING THE "F3" FUNCTION. IN BOTH CASES, THE LOCATE LOG SIMPLY CONTAINED THE TERM "AUTOLOCATE" TO REFER TO THE START-OF-DAY INVENTORY UTILIZED BY GOLDMAN'S AUTOMATED MODEL AS THE SOURCE OF SECURITIES SUPPORTING THE LOCATE. AS A RESULT OF THE CONDUCT DESCRIBED ABOVE, GOLDMAN WILLFULLY VIOLATED SECTION 17(A) OF THE EXCHANGE ACT AND RULES 203(B)(1) AND 203(B)(1)(III) OF REGULATION SHO PROMULGATED UNDER THE EXCHANGE ACT.

Initiated By: UNITED STATES SECURITIES AND EXCHANGE COMMISSION

The problem with Goldman's autofill system was that it used the number of shares available to borrow at the beginning of that day, which had already been accounted for. After using the auto-locate feature, the demand team didn't even verify the accuracy of the autofill feature or document which method was used to locate the shares for each order... and this happened for 5 years..

Just goes to show how dedicated firms like Goldman Sachs truly are to the smallest of details, you know? Great f*cking work, guys.

By the way, I have to show one of Goldman's short sale indicator violations... It's too good to pass up.

Disclosure 15 of 148

Reporting Source: Regulator
Current Status: Final
Allegations: FINRA RULES 2010, 4560, NASD RULES 2110, 3010, 3360, NYSE RULE 421 - GOLDMAN SACHS EXECUTION & CLEARING, L.P., FOR SHORT INTEREST REPORTING CYCLES FOR ABOUT FOUR YEARS, SUBMITTED REPORTS THAT DID NOT INCLUDE SHORT INTEREST POSITIONS OF OVER 380 MILLION SHARES. THE FIRM SUBMITTED TO FINRA AND THE NEW YORK STOCK EXCHANGE SHORT INTEREST POSITION REPORTS THAT WERE INCORRECT OR FAILED TO REPORT SHORT INTEREST POSITIONS. THE FIRM'S SUPERVISORY SYSTEM DID NOT PROVIDE FOR SUPERVISION REASONABLY DESIGNED TO ACHIEVE COMPLIANCE WITH NASD, NYSE AND FINRA RULES REGARDING SHORT INTEREST REPORTING.
Initiated By: FINRA
Date Initiated: 01/07/2014

At some point, you just have to laugh at these ass clowns... I mean seriously... one violation for a 4 year period involving over 380,000,000 short interest positions... they have plenty of other short interest violations, I just laughed at how the magnitude of this one was summarized by FINRA with 10 lines and roughly 4 minutes... whoever wrote that one must have been late for lunch.

The last thing I'd like to note here is the way in which short sellers use options to "cover" their positions. Wes gave a great overview of this in the AMA (*starting at 6:25*). Basically, one group will buy puts and another group buys calls. This creates a synthetic share that is only provided if the option is activated. Regardless, short sellers will use that synthetic share to cover their short position and the regulators actually accept it...

However, as Wes points out, most of those options expire without being activated which means the share is never delivered. This expiration can be set months down the road and allows the short seller to keep kicking the can.

I doubt I need to say this, but we all remember the wild options activity that was happening shortly after GameStop spiked in January. [u/HeyItsPixel](#) was one of the first to point this out. While a lot of that activity was on the retail front, I suspect a lot of it was done by short sellers to cover those positions.

Section 5: Hedgies are f*cked...

I'm officially +20 pages deep and there's still so much I'd like to say. It's best saved for another time and another post, I suppose. So I guess I'll wrap all of this up with some of the best news I can possibly provide...

It all started with a [73 page PDF](#) that was published in 2005 by a silverback named John D. Finnerty.

John was a Professor of Finance at Fordham University when he published "*short selling, death spiral convertibles, and the profitability of stock manipulation*". The document is loaded with sh*t that's incredibly relevant today, especially when it comes to naked short selling. He dives into the exact formula that short sellers use, which is far beyond what my wrinkled brain can interpret, alone...

However, when firms are naked shorting a company with the goal of bankrupting them, they leave footprints which are only explained by this event. The proof is in the pudding, so to speak.

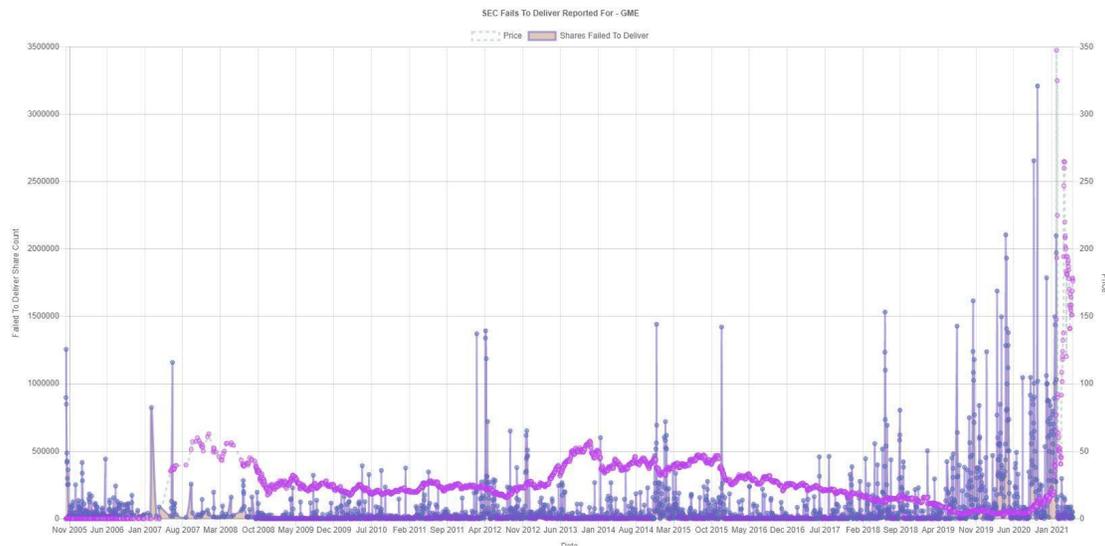
Building a short position of H/B to drive $P^*(3)$ to zero would involve naked shorting more shares than the firm has outstanding because $H/B > (A - L)/B$.⁶⁵ The manipulator can not drive the share price close to zero unless he can naked short an extraordinary number of shares.⁶⁶ This form of manipulation would result in a precipitous drop in the firm's share price to well below its intrinsic value, unusually heavy trading volume, and unusually large and persistent fails to deliver at the NSCC. Preventing this activity requires the clearing house to enforce its buy-in rules for fails to deliver and to impose penalties on short positions that are rolled over for an extended period, which is the purpose behind new Regulation SHO (SEC, 2004).

Any of this sound familiar??

"The manipulator can not drive the share price close to zero unless he can naked short an extraordinary number of shares... this form of manipulation would result in... unusually heavy trading volume, and unusually large and persistent fails to deliver at the NSCC".

Anyone else remember the volume in GME during the run-up in January? The total volume traded between **1/31/2021 and 2/5/2021 was 1,508,793,439 shares**, or an average daily trade volume of **88,752,555 shares**. On 1/22/2021, the volume reached 197,157,946... that's roughly 3x the number of shares that exist..

if this doesn't sound like unusual volume then I'm not sure what is. Furthermore, the FTD report on GameStop was through the roof during this time:



invest in its equity. Customers may cease doing business with it as well because its warranties will appear worthless. Eventually, the firm will exhaust its liquidity and have to file for bankruptcy. The manipulator will be relieved of its obligation to cover its short position if the firm's shares are cancelled in bankruptcy.⁶⁸ This scenario leads to a zero cost of covering the short positions. This form of manipulation may involve a single manipulator or a group of manipulators who act in concert and make an unusually high percentage of apparently unlucky equity investments that become worthless in bankruptcy, all of which have unusually high trading volume, large and persistent fails to deliver, and a precipitous drop in share price below the stock's intrinsic value (often to just pennies a share).

Notice the statement where the manipulator will be relieved of its obligation to cover **IF** the firm's shares are cancelled in bankruptcy? Did you happen to see footnotes 65 & 66 in the first screenshot of his PDF? It references a company that he used for his analysis...

⁶⁶ The NASD reported that Charter Communications had short interest of 88,520,000 shares in January 2005, but Charter reported having outstanding shares minus shares held by insiders of only 36,600,000 shares.

Charter Communications had a whopping 241.8% short float in 2005... The ONLY way the manipulator could have escaped this was by bankrupting the company and relieving the obligation to repurchase those shares...

Guess what happened to Charter? They filed for [bankruptcy](#) in 2009...

However, unlike John's example where naked short sellers were driving down the price without opposition, GameStop had extremely high demand from retail investors to counter this activity. As I have discussed with Dr. T and Carl Hagberg, the run-up in volume during January and February was largely conducted by naked short sellers in an attempt to suppress the share price. As I have shown in the example with Goldman Sachs, firms will short sell during a buy-in for the same exact reason. To stabilize the price, you must stabilize supply and demand.

...You know what Charter didn't have?

AN ARMY OF APES TO HODL THE STONK

DIAMOND. F*CKING. HANDS.