MEMO# 20874

February 16, 2007

Institute Letter on SEC Rule Proposals Relating to Short Selling

[20874]

February 16, 2007

TO: SEC RULES MEMBERS No. 20-07
EQUITY MARKETS ADVISORY COMMITTEE No. 8-07
CLOSED-END INVESTMENT COMPANY MEMBERS No. 12-07
ETF ADVISORY COMMITTEE No. 5-07 RE: INSTITUTE LETTER ON SEC RULE PROPOSALS RELATING TO SHORT SELLING

The Institute has filed a comment letter with the Securities and Exchange Commission on proposed rules to amend Regulation M relating to short selling in connection with a public offering. [1] The most significant aspects of the comment letter are summarized below and a copy of the letter is attached.

The comment letter states that while the Institute supports the goals of the proposal, we are concerned that the proposal could result in inadvertent violations by investment companies of Rule 105 of Regulation M. Currently, Rule 105 prohibits a person from covering a short sale with securities sold in an offering if such person sold short within five days prior to the pricing of the offering or the period beginning with the filing of the registration statement and ending with pricing, whichever is shorter (the “five-day period”). To address efforts to evade the prohibitions of Rule 105, the proposal would instead make it unlawful for a person to effect a short sale during the five-day period and then purchase the security in an offering.

The letter states that our concerns arise from the application of the proposed rules to any “person.” Specifically, it is unclear whether a “person” for purposes of Rule 105 would include each fund within a complex, each series of a fund, or each subadvised portion of a single fund. The letter further states that if a "person" is deemed to include all funds within a fund complex, all series of a fund, or collectively all the portions of a particular fund that has multiple subadvisers, the proposal could create difficulties for funds effecting transactions in securities that are the subject of an offering. The letter provides several examples of situations where these difficulties may occur.

The letter states that these situations do not raise the concerns that are the subject of, and are not the type of conduct that was the impetus for, the SEC's proposal. Accordingly, to prevent any unintended consequences for funds, the letter recommends that the SEC clarify that each individual fund within a fund complex, each series of a fund, and each subadvised portion of a particular fund, is a separate "person" for purposes of Rule 105. The letter states that such guidance would be consistent with exemptive rules under the Investment Company Act, will prevent inadvertent violations of Rule 105 by funds, and will preserve the protections and goals of the amendments to Regulation M.

Ari Burstein
Senior Counsel - Securities Regulation

Attachment

endnotes

[1] SEC Release No. 34-54888 (December 6, 2006), 71 FR 75002 (December 13, 2006). The proposal can be found on the SEC's website at http://www.sec.gov/rules/proposed/2006/34-54888.pdf.

Copyright © by the Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.