

MEMO# 22893

September 22, 2008

SEC Issues Amendments to Short Sale Emergency Orders and Expands Related Enforcement Efforts

[22893]

September 22, 2008

TO: ETF ADVISORY COMMITTEE No. 24-08

EQUITY MARKETS ADVISORY COMMITTEE No. 44-08

SEC RULES MEMBERS No. 93-08

CLOSED-END INVESTMENT COMPANY MEMBERS No. 37-08 RE: SEC ISSUES AMENDMENTS
TO SHORT SALE EMERGENCY ORDERS AND EXPANDS RELATED ENFORCEMENT EFFORTS

Enforcement Investigations

The Securities and Exchange Commission has taken several additional actions to address recent market developments. On Friday, the Commission issued a press release announcing an expansion of its ongoing investigation into possible market manipulation in the securities of certain financial instruments. [\[1\]](#) According to the release, hedge fund managers, broker-dealers, and institutional investors with significant trading activity in financial issuers or positions in credit default swaps will be required, under oath, to disclose those positions to the Commission and provide certain other information.

The Commission also approved a formal order of investigation that will allow Commission enforcement staff to obtain additional documents and testimony by subpoena. The press release stated that investigators from NYSE Regulation and the Financial Authority Regulatory Authority will be conducting a separate, parallel inquiry in coordination with the Commission to address concerns about recent short selling activity.

Revisions to Temporary Short Sale Reporting Requirement

On Sunday, the Commission approved amendments to its emergency order of September 18 requiring that certain institutional money managers report their new short sales of certain publicly traded securities. [2] Specifically, the amended order provides that the information disclosed by investment managers on new Form SH will be nonpublic initially, but will be made available to the public via the Commission's EDGAR website two weeks after it is electronically filed with the Commission. The amended order will take effect at 12:01 a.m. EDT on Monday, September 22, 2008.

The amended order states that the Commission is now permitting the non-public filing of Form SH in order to maintain fair and orderly securities markets and prevent substantial disruption in the securities markets. It also states the Commission's beliefs that: (1) the non-public submission of Form SH may help prevent artificial volatility in securities and further downward swings that are caused by short selling, while at the same time, providing the Commission with useful information to combat market manipulation and (2) by two weeks after the due date for Form SH the reasons to maintain the information as non-public will have diminished.

Revisions to Temporary Ban of Short Sales

On Sunday, the Commission amended the emergency order of September 19 temporarily banning short selling in financial institution securities ("covered securities"). [3] The Commission delegated to each national securities exchange the authority to identify additional listed companies that qualify for inclusion in the list of covered securities. [4] The additional companies must be in one of the following categories:

- banks, as defined in 15 U.S.C. 78c(a)(6);
- savings associations, as defined in 15 U.S.C. 78c(a)(46);
- registered brokers or dealers, as defined in 15 U.S.C. 78c(a)(48);
- insurance companies, as defined in 15 U.S.C. 80a-2(a)(17);
- investment advisors, both registered and unregistered;
- banks, savings associations, brokers, dealers, and insurance companies that are similar to those covered by the foregoing statutory definitions but which are regulated by a foreign (rather than U.S.) regulatory authority;
- companies that control or have majority ownership of companies that meet one of the above criteria.

All companies that were covered by the earlier order will continue to be covered by the revised short sale prohibition. In addition, companies that were on the original list, or that fall into one of the categories expected to be covered by the amended order, may opt out of the application of the revised short sale prohibition by informing the national securities exchanges of that determination.

The amended order also provides a number of new exceptions and clarifications to the original order. First, it provides an exception to allow short sales that occur as a result of the expiration of futures contracts held prior to effectiveness of the order. The original

order had provided a limited exception only for short sales that occur as a result of automatic exercise or assignment of an equity option held prior to effectiveness of the order due to expiration of the option. Second, to allow for creation of long call options, it excepts short sales that occur as a result of assignment to call writers upon exercise by the holder of the call. Third, the amended order clarifies that the short sale requirements do not apply to persons that effect sales of restricted securities (i.e., sales of covered securities pursuant to Rule 144 of the Securities Act of 1933).

Fourth, the amended order modifies the original market maker exception, which permitted a market maker to effect a short sale as part of a bona fide market making and hedging activity related directly to bona fide market making in derivatives on the covered securities. The original exception expired at 11:59 p.m. on September 19, 2008. The amended order reinstates the exception for the duration of the emergency order, clarifies that the exception applies to all market makers, including over-the-counter market makers, and specifies that it applies to bona fide market making and hedging activity related directly to bona fide market making in ETFs and exchange traded notes of which covered securities are a component. The market maker exception is limited, however, so that a market maker may not effect a short sale in a covered security if it knows that the customer's or counterparty's transaction will result in the customer or counterparty establishing or increasing an economic net short position. [5]

Heather L. Traeger
Assistant Counsel

endnotes

[1] See SEC Expands Sweeping Investigation of Market Manipulation, SEC Press Release 2008-214, September 19, 2008.

[2] See Amendment To Emergency Order Pursuant to Section 12(K)(2) of the Securities Exchange Act of 1934 Taking Temporary Action to Respond to Market Developments, SEC Release No. 58591A, September 21, 2008. The amended order may be found at: <http://www.sec.gov/rules/other/2008/34-58591a.pdf>. See also Memorandum to Equity Markets Advisory Committee No. 43-08, ETF Advisory Committee No. 23-08, SEC Rules Members No. 90-08, and Closed-End Investment Company Members No. 36-08, dated September 19, 2008 [22888].

[3] See Amendment To Emergency Order Pursuant to Section 12(K)(2) of the Securities Exchange Act of 1934 Taking Temporary Action to Respond to Market Developments, SEC Release No. 58611, September 21, 2008. The amended order may be found at: <http://www.sec.gov/rules/other/2008/34-58611.pdf>. See also Memorandum to Equity Markets Advisory Committee No. 43-08, ETF Advisory Committee No. 23-08, SEC Rules Members No. 90-08, and Closed-End Investment Company Members No. 36-08, dated

September 19, 2008 [22888].

[\[4\]](#) The lists from the securities exchanges are subject to amendment.

[\[5\]](#) Market makers relying on the exception must publish a notice on their Internet website that states that the market maker may not knowingly effect a short sale as described in the limitation.

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