

INVESTMENT FUNDS ALERT



SEC HALTS SHORT SELLING IN FINANCIAL STOCKS, REQUIRES DISCLOSURE OF SHORT SALES AND RELAXES RULE 10B-18 CONDITIONS

The Securities and Exchange Commission (SEC) took temporary emergency action on September 18, 2008, to increase market transparency and liquidity in an effort to restore confidence in the financial markets. The SEC's actions consist of three emergency orders relating to (1) a prohibition of short sales in certain financial stocks,¹ (2) a requirement to report on a weekly basis daily short sales by institutional investment managers who currently file reports on Form 13F² and (3) a suspension of certain timing and volume conditions on issuer repurchases under Rule 10b-18 of the Securities Exchange Act of 1934 (the "Exchange Act").³ The effective date of each order is set forth below. These actions are in addition to the new rules adopted by the SEC on September 17, 2008, to curb naked short selling abuses.

SHORT SALE PROHIBITION IN FINANCIAL STOCKS

The SEC issued an emergency order (the "Short Sale Order") prohibiting all persons from selling short⁴ any publicly traded securities of 799 financial institutions, including banks, insurance companies and securities firms, as defined by certain Standard Industrial Classification (SIC) codes (each a "Prohibited Security"). The Short Sale Order includes an appendix listing the name and ticker symbol of each Prohibited Security. We have been informally advised that only the stocks corresponding to the ticker symbols listed on the appendix (and not other securities issued by the financial institutions) are Prohibited Securities. We also understand that the list will be updated to add certain names that were inadvertently omitted.

The Short Sale Order includes some limited exceptions from the prohibition against short selling. First, registered market makers, block positions or other market makers required to quote in the over-the-counter market are excepted from the short sale prohibition, so long as

¹ SEC Release No. 34-58592 (September 18, 2008).

² SEC Release No. 34-58591 (September 18, 2008).

³ SEC Release No. 34-58588 (September 18, 2008).

⁴ The term "short sale" means any sale of a security that the seller does not own or any sale that is consummated by the delivery of a security borrowed by, or for the account of, the seller. Terms referenced in the definition of "short sale" shall have the same meaning as set forth in Rule 200 of Regulation SHO. "Short positions" to be reported are those resulting from such short sales.

they are selling short a Prohibited Security as part of bona fide market making in such security. In addition, the prohibition against short selling a Prohibited Security does not apply to any person who sells short a Prohibited Security as a result of an automatic exercise or assignment of an equity option due to the expiration of that option, if such person held the option prior to effectiveness of the Short Sale Order.

Effective Date. The Short Sale Order is immediately effective and will terminate at 11:59 p.m. EDT on October 2, 2008, unless further extended by the SEC. However, the Short Sale Order will not be effective for options market makers until 11:59 p.m. EDT on September 19, 2008, for any short sale transactions in Prohibited Securities that are a part of bona fide market making and hedging activities related to market making in derivatives.⁵

DISCLOSURE OF SHORT SALES BY FORM 13F FILERS

The SEC also issued an emergency order requiring certain institutional investment managers to report information concerning daily short sales⁴ of securities. The SEC is requiring every institutional investment manager that exercises investment discretion with respect to accounts holding Section 13(f) securities and that has filed or was required to file a Form 13F for the calendar quarter ended June 30, 2008, to file a report on a new form-Form SH-with the SEC, to provide information relating to any short sales effected by such manager. The Form SH must be filed electronically and will be publicly available through EDGAR. The Form SH filing must be made on the first business day of each week immediately following a week in which the institutional investment manager has effected any short sale with respect to any Section 13(f) security that is not an option. The Form SH filing must reflect the-

- number and value of securities sold short during the day (except for short sales in options)
- opening short position
- closing short position
- largest intraday short position
- time of the largest intraday short position

for the security on each calendar day of the prior week in which the institutional investment manager engaged in trading with respect to short sales. An institutional investment manager will not be required to make a Form SH filing if it has not effected any short sales of a Section 13(f) security since its previous Form SH filing.

Notwithstanding the above, an institutional investment manager need not report short positions if (1) the short position constitutes less than one quarter of one percent of the class of the issuer's Section 13(f) securities issued and outstanding, and (2) the fair market value of the short position in the Section 13(f) securities is less than \$1 million.

Effective Date. This disclosure requirement only applies to short sales effected after 12:01 a.m. EDT on September 22, 2008, and will terminate at 11:59 p.m. on October 2, 2008, unless further extended by the SEC. Based on the effective date, the first Form SH will be required to be filed on September 29, 2008.

⁵ On September 19, 2008, the SEC's Division of Trading and Markets issued a statement recommending to the SEC a modification to the Short Sale Order to extend the exemption for hedging activities by exchange and over-the-counter market makers in derivatives on Prohibited Securities for the life of the Short Sale Order.

CHANGES TO TIMING AND VOLUME CONDITIONS UNDER RULE 10B-18

The third emergency order by the SEC suspends certain timing conditions and alters volume conditions relating to issuer share repurchases under Rule 10b-18 under the Exchange Act. Rule 10b-18 provides a safe harbor from the anti-manipulation provisions of Sections 9(a)(2) and 10(b) of the Exchange Act and Rule 10b-5 thereunder for purchases by an issuer of its common stock if the purchases comply with certain timing, volume, price and manner-of-purchase conditions. Because the SEC has determined that issuer repurchases represent an important source of liquidity during times of market volatility, this emergency order temporarily alters the timing and volume conditions in Rule 10b-18 to provide issuers additional flexibility and certainty regarding repurchases during the current market conditions.

Timing Conditions. Rule 10b-18(b)(2) sets forth certain conditions for the timing of purchases. Among other things, to remain within the safe harbor, purchases pursuant to Rule 10b-18 must not be (1) the opening (regular way) purchase reported in the consolidated transaction or quotation reporting system or (2) effected during either the 10 minutes or 30 minutes before the scheduled close of the market, depending on the security's average daily trading volume (ADTV) for the previous four full calendar weeks and public float value. Pursuant to the SEC's order, these time of purchases conditions, as set forth in Rule 10b-18(b)(2)(i)-(iii), are temporarily suspended.

Volume Conditions. Rule 10b-18(b)(4) sets forth certain conditions for the volume of purchases, including that the total volume of Rule 10b-18 purchases effected by or for the issuer on any single day must not exceed 25 percent of the ADTV for the security. Pursuant to the SEC's order, this volume condition is temporarily modified, so that the amount of Rule 10b-18 purchases must not exceed 100 percent of the ADTV for the security.

Except as set forth above, an issuer must meet all other conditions in Rule 10b-18 to take advantage of the safe harbor with respect to share repurchases.

Effective Date. This order regarding Rule 10b-18 is effective beginning at 12:01 a.m. EDT on September 19, 2008, and will terminate at 11:59 p.m. on October 2, 2008, unless further extended by the SEC.

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