

INVESTMENT FUNDS ALERT

SEC ANNOUNCES NEW SHORT SALE TRANSPARENCY REGIME AND THE FINAL ADOPTION OF SHORT SALE CLOSE-OUT RULES

On July 27, 2009, the Securities and Exchange Commission (SEC) announced that it will allow the rule that requires the filing of Form SH, Rule 10a-3T under the Securities Exchange Act of 1934 (the "Exchange Act") to expire and will, instead, coordinate with securities exchanges and registered securities associations ("SROs") to require the reporting of short sale volume and transaction data through the SROs. In addition, the SEC adopted a final version of Rule 204 of Regulation SHO (the "Close-Out Rule"), which is designed to curb "naked" short selling abusive practices. The SEC also announced that it will hold a roundtable on September 30, 2009, to solicit comments on short sale regulation from a variety of investors, industry participants, issuers and the academic community.

SHORT SALE REPORTING

Pursuant to an emergency order issued on September 18, 2008, and Rule 10a-3T under the Exchange Act adopted on October 15, 2008, the SEC required all persons that were required to file a Form 13F to confidentially report short positions to the SEC on Form SH. Rule 10a-3T is set to expire by its terms on August 1, 2009.

The SEC announced that it decided to permit Rule 10a-3T to expire and to work instead with several SROs to make certain information regarding short sales available in the next few weeks. Specifically, the SRO disclosure will include daily publication of short sale volume information in each individual equity security for that day, as well as information regarding individual short sale transactions in all exchange-listed equity securities on a one-month delay basis. The press release does not state what information will be provided regarding individual trades, whether the names of the entity entering into individual transactions will be disclosed or what the mechanism will be for transmittal of information to the SROs. We understand, however, that the SEC has provided informal guidance that the SROs will not disclose the names of the persons who entered into the short sales, but the actual scope of disclosure will be set forth in the adopting regulations.

The SEC also announced that it plans to enhance the publication of "fails to deliver" on its Web site on bimonthly basis in the next few weeks.

FINAL CLOSE-OUT RULE

The final version of the Close-Out Rule is substantially similar to Rule 204T of Regulation SHO adopted on October 14, 2008, with minor modifications. As with Rule 204T of Regulation SHO, the final version of the Close-Out Rule requires a clearing broker or other participant of a clearing agency (each a "clearing broker") or introducing firm to close out any sales of equity securities

(including short sales and certain long sales that cannot be properly documented) for which the seller fails to deliver equity securities by the settlement date, by borrowing or purchasing securities of like kind and quantity by the beginning of trading on the business day following the original settlement date. Also, if the clearing broker or introducing firm fails to deliver securities and does not close out the failure to deliver by the next settlement day, such firm will not be able to accept any short sale order in that equity security from any person without first borrowing or arranging to borrow the security and closing out the original failure to deliver. For more information on Rule 204T as adopted in October 2008, see our alert here.

The SEC made several modifications to the final version of the Close-Out Rule in the adopting release for the final rule. The Close-Out Rule as finally adopted will—

- allow clearing brokers to close out a failure to deliver relating to a documented long sale by borrowing securities
- expand the scope of securities that are entitled to an extended settlement cycle from securities sold only pursuant to Rule 144 under the Securities Act of 1933 to all securities that a person is deemed to own pursuant to Rule 200 of Regulation SHO that he or she intends to deliver after all restrictions are removed
- reduce the extended settlement cycle to 35 calendar days after the trade date instead of 36 settlement days following the settlement date
- allow market makers to close out fail to deliver positions by borrowing instead of purchasing securities
- eliminate the exemption for market makers from the pre-borrowing requirement if a failure to deliver is not closed out
- allow a clearing broker to be exempt from the pre-borrowing requirements of the Close-Out Rule if it borrows securities prior to the end of regular trading hours on the settlement date and satisfies the other requirements of the Close Out Rule
- clarify that it will not deem a clearing broker to have fulfilled its obligations under the rule if it knows or has reason to know that a counterparty to an arrangement will not deliver securities in settlement of the purchase or borrow.

ROUNDTABLE

The SEC will host a roundtable on September 30, 2009, to solicit the views of investors, issuers, industry insiders and the academic community regarding a variety of trading and market practices (and potential new measures targeting short sales), including, among other possibilities: (i) adding a short sale indicator to tapes reporting exchange-traded securities, (ii) requiring public disclosure of large individual positions and (iii) implementing a pre-borrow or enhanced locate requirement for short sellers “possibly on a pilot basis.” The SEC also stated that it will continue to consider other previously announced proposals and initiatives relating to short sales, including the short sale price test.

CONTACT INFORMATION

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