

T O O U R F R I E N D S A N D C L I E N T S
M e m o r a n d u m

September 22, 2008



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SEC Amends Short Selling Ban and Reporting Requirements

Continuing its stream of emergency actions, the Securities and Exchange Commission ("SEC") announced material amendments late Sunday to the emergency orders issued last Friday prohibiting the short selling of publicly traded securities of 799 financial firms (the "Short Sale Ban Order") and requiring Section 13(f) institutional investment managers to report short sales effected on or after Monday, September 22, 2008, (the "Reporting Order"). We previously addressed last week's actions by the SEC in our September 20th client memorandum.¹

- **Amendment to the Short Sale Ban Order.** The SEC determined, among other things, (i) to delegate to each national securities exchange the authority to establish its own list of publicly-traded financial institutions from its market place to be covered by the Short Sale Ban Order; (ii) to clarify that investment advisers and their holding companies are among the categories of financial institutions whose securities are subject to the ban; and (iii) to allow covered institutions to opt out of the Short Sale Ban Order. See <http://www.sec.gov/news/press/2008/2008-218.htm>.
- **Amendment to the Reporting Order.** The SEC changed its determination to make new short sale reports immediately public. Instead, the new Form SH reports will be nonpublic for two weeks after they are due to be electronically filed with the SEC. See <http://www.sec.gov/news/press/2008/2008-217.htm>.

The amendments are described briefly below.²

Short Sale Ban Order

Adopting a principle-based approach, the SEC determined to provide that each national securities exchange will select the individual publicly-traded institutions listed on such exchange to be added to the SEC's ban on short selling. This approach replaces the SEC's role as the gatekeeper responsible for selecting the covered companies in deference to the listing markets which have more specific knowledge as to the nature of each listed company's primary business. The SEC continues to oversee the process, however, and expanded the list of potentially covered companies by adding registered and unregistered

¹ See <http://www.friedfrank.com/siteFiles/Publications/856B9B6B8B86D83CABEE9BD4371A0445.pdf>.

² The amendments to the SEC's emergency orders do not change the effective terms of those orders. Consequently, these actions will remain effective until 11:59 P.M. Eastern Time on Thursday, October 2, 2008, subject to the SEC's right to extend any or all of the relevant orders until October 18, 2008.

investment advisers to the category of financial institutions that may be identified by the listing markets. The current, amended directive posted on the listing market web sites is that the lists should cover:

- 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);
- 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 US) regulatory authority;
- US and foreign investment advisers, both registered and unregistered; and
- companies that control or have majority ownership of companies that meet one of the above criteria.

Companies who have not been identified but who believe they should be added to the list, or companies that want to opt out of the Short Sale Ban Order, should contact their listing market. Here are web site links to the NYSE Euronext and NASDAQ releases and supplemental lists:

- http://www.nyse.com/about/listed/1222078675703.html?sa_campaign=/internal_ads/ticker/09222008seclist; and
- <http://www.nasdaqtrader.com/TraderNews.aspx?id=RA2008-021>.

The Short Sale Ban Order, as amended, further excepted the following:

- Sales of covered securities pursuant to Rule 144 of the Securities Act of 1933, as amended, due to the fact that such sales are actually long sales³;
- Short sales effected as a result of automatic exercise or assignment of an equity option, or in connection with settlement of a futures contract, that is held prior to the effectiveness of the Short Sale Ban Order due to expiration of the option or futures contract; and
- The writer of a call option that effects a short sale as a result of assignment following exercise by the holder of the call.

The SEC, in addition, expanded the exception contained in the Short Sale Ban Order to cover all bona fide market makers in the securities of any covered financial institution. This broader exception, however, requires that in the future a market maker may not sell short if the market maker knows a customer or counterparty is increasing an economic net short position in the shares of the covered financial institution. A market maker relying on this exception is required, as soon as operationally practicable, to publish a notice on its internet web site. The notice must state that the market maker “may not knowingly effect a

³ See, e.g., Securities Act Release No. 8869 (Dec 6, 2007), at footnote 90.

short sale as part of bona fide market making and hedging activity related directly to bona fide market making in a derivative security based on a Covered Security, if the customer's or counterparty's transaction will result in the customer or counterparty establishing or increasing" an economic net short position.

Reporting Order

Last week's emergency order added new short sale reporting requirements for money managers and created a new form for that purpose, Form SH. In recognition of market practicalities, as well as in an effort to prevent artificial volatility in trading and to avoid further downward selling pressure caused by short sales, the SEC determined that each filed Form SH will be kept confidential for two weeks from that form's due date. As a result, the new requirements allow between two and three weeks during which money managers may maintain as confidential their strategic and proprietary trading decisions involving short sales. This amends the SEC's original requirement that the form would be public upon its electronic filing on EDGAR. The delay in reporting, however, is a relatively brief period in contrast to the normal 45-day delay institutional money managers experience when reporting long positions on Form 13F.

In order to obtain this nonpublic treatment, an institutional investment manager will need to label its Form SH as nonpublic by adding the phrase NON-PUBLIC (in bold and capital letters) at the bottom and top of each page of the entire form, *i.e.*, each page(s) of the Form SH cover page, the Form SH summary page, and the Form SH information table.

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If you have any questions about these very recent actions by the SEC, or if you would like guidance in seeking to be added to or removed from the Short Sale Bar list, please contact any of the attorneys below.

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