

SEC Exercises Emergency Authority to Restrict and Monitor Short Selling and to Relax Stock Repurchase Safe Harbor

Overview

Over the course of the past week, the Securities and Exchange Commission (SEC) and other financial regulators around the world have taken a number of dramatic steps to restrict and monitor short selling. Using its emergency authority, the SEC approved several new temporary orders that require disclosure of short selling activity, prohibit short sales in the shares of certain financial firms, and provide additional flexibility to issuers for their share repurchase programs under Rule 10b-18 of the Securities Exchange Act of 1934 (Exchange Act). In addition, the SEC Enforcement Division and New York Attorney General Andrew Cuomo have reportedly begun wide-ranging investigations into short selling in the financial markets.

Disclosure of Short Sales

The SEC's new short-selling disclosure order (Disclosure Order) applies to every institutional investment manager that has filed or was required to file a Form 13F for the calendar quarter ended June 30, 2008. The institutional investment manager will be required to file a report on the new Form SH with the SEC on the first business day of every calendar week immediately following a week in which it effected short sales, but the report will not be made available to the public until two weeks from the date it is filed. This disclosure requirement will only apply to short sales effected after the effective date of the Disclosure Order (September 22, 2008). The first Form SH is required to be filed on September 29, 2008 and would be available to the public on the SEC's EDGAR system on October 13, 2008. The Disclosure Order expires on October 2, 2008, unless further extended.

The Form SH must include disclosure of the number and value of securities sold short for each section 13(f) security (except for short sales in options) and the opening short position, closing short position, largest intraday short position, and the time of the largest intraday short position, for that security during each calendar day of the prior week. An institutional investment manager, however, need not report short positions otherwise reportable if: (i) the short position constitutes less than 0.25% of the class of outstanding section 13(f) securities; and (ii) the fair market value of the short position is less than \$1 million. In addition, no report is required if no short sales of a section 13(f) security have been effected since the previous filing of a Form SH.

Prohibition on Short Sales of Certain Financial Firms

The SEC, acting in concert with the U.K. Financial Services Authority, also took temporary emergency action to prohibit short selling in the shares of certain financial firms (Short Sale Order). The SEC's action initially applied to 799 financial firms, but the SEC has delegated to each national securities exchange the authority to identify additional listed companies that qualify for the prohibition. The SEC expects these lists to cover banks, savings associations, broker-dealers, investment advisers, and insurance companies, whether domestic or foreign, and the owners of any of these entities. If an issuer does not want to be covered by the prohibition on short sales, the issuer should notify the applicable exchange and,

pursuant to authority granted to the national securities exchanges by the SEC, the exchange may exclude that issuer from its list of covered financial firms. The current list of restricted companies included in the Short Sale Order, as supplemented by the New York Stock Exchange can be downloaded [here](#). There are limited exceptions from the prohibition for market makers and for short sales that occur as a result of automatic exercise or assignment of an equity option held prior to effectiveness of the Short Sale Order due to expiration of the option. The Short Sale Order will expire October 2, 2008, unless further extended.

Share Repurchases under Rule 10b-18

The SEC also temporarily suspended certain volume and timing restrictions on Rule 10b-18 share repurchases. In repurchasing their shares, issuers may now be the opening (regular way) purchase and do not need to suspend purchases at the end of the regular market session. However, after-market trading continues to be outside the scope of the safe harbor. Issuers may repurchase, on a daily basis, up to 100% of the reported average daily trading volume (ADTV) for the previous four calendar weeks. This is an increase from the 25% level ordinarily permitted under the rule. The Rule 10b-18 action will expire at 11:59 p.m. on October 2, 2008, unless further extended.

Contact Information

If you would like to learn more about the issues raised by this update, please contact your usual Ropes & Gray adviser.

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