

Regulatory Circular RG05-20

Date: February 17, 2005

To: Members and Member Organizations

From: Division of Regulatory Services

Subject: Regulation SHO (Short Sales)

- SEC No-Action Letter Concerning Marking of Orders
- Market-Makers That Perform Their Own Locates

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This Regulatory Circular supplements two previous Regulatory Circulars concerning Regulation SHO¹ (RG04-113 and RG04-127). These Regulatory Circulars may be found on the CBOE website at:

<http://www.cboe.org/publish/RegCir/RG04-113.pdf>
<http://www.cboe.org/publish/RegCir/RG04-127.pdf>.

KEY POINTS

- The Securities and Exchange Commission (“SEC”) has issued a no-action letter concerning the Regulation SHO requirement to mark a short sale order “*short exempt*” when the seller is relying on an exemption from a price test. The letter provides that the SEC will not recommend enforcement action if such short sale orders are marked “*short*” rather than “*short exempt*.”
- The no-action relief applies only to specific price test exemptions granted by the SEC. These specific exemptions are listed in an appendix to the SEC’s no-action letter.
- The stocks included in a pilot established by the SEC to allow short sales of such stocks without regard to any price test are not covered by the no-action letter. Therefore, unless and until the SEC provides specific relief,

¹ Reg. SHO is described in Exchange Act Release No. 34-50103 (July 28, 2004), 69 FR 48008 (August 6, 2004). An online copy can be found at: www.sec.gov/rules/final/34-50103.htm.

short sales of pilot stocks must be marked “*short exempt*.” The pilot is set to commence on May 2, 2005.

- Based on the letter, short sales of exchange traded funds (ETFs) that have been granted an exemption from a price test can be marked “*short*” rather than “*short exempt*.” Market centers generally process short sales of such ETFs without regard to price test restrictions on an automated basis. Therefore, such orders can continue to be marked “*short*” and processed, as they have been, without regard to any price test.
- An after-hours crossing session is another example of a situation in which an exemption from, or modification of, a short sale price test may apply. Short sales during such sessions are generally processed by market centers without regard to, or under modified, price test restrictions on an automated basis, and can continue to be marked “*short*” and processed, as they have been.
- The no-action letter requires that short sales eligible for the relief must be marked “*short*” and may not be marked “*long*.” Additionally, the requirement to use the “*short exempt*” designation remains in force for other situations involving reliance on an exception from a short sale price test.
- A copy of the SEC’s no-action letter may be found on its website at: <http://www.sec.gov/divisions/marketreg/mr-noaction/sia010305.htm>
- A short sale by a market-maker is not exempt from Regulation SHO’s locate² requirement when the subject security is a threshold security and the market-maker has a fail to deliver in the security that has lasted for 13 settlement days (10 business days from settlement date).
- In the event that a market-maker performs its own locate, the market-maker must record in writing the date that the locate was accomplished; the name of the stock and the number of shares located; the length of time for which the locate is valid and the name of the person from whom the locate was obtained. Such records must be maintained for a period of not less than three years, the first two years in an easily accessible place.

Questions concerning Regulation SHO may be directed to Robert Gardner, (312) 786-7937, or James Adams, (312) 786-7718, in the Exchange’s Department of Financial and Sales Practice Compliance.

² The word “locate” here means the Regulation SHO requirement to ensure prior to entering a short sale order that the security being sold short has been borrowed or a bona-fide arrangement has been made to borrow the security.