

## Regulatory Circular RG05-46

Date: May 2, 2005

To: Members and Member Organizations

From: Division of Regulatory Services

Subject: Regulation SHO (Short Sales)

- Pilot Program Temporarily Suspending Short Sale Price Test for Certain Securities Commences on May 2, 2005
- SEC No-Action Letter Concerning Marking of Short Sale Orders in Pilot Securities

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This Regulatory Circular supplements three previous Regulatory Circulars concerning Regulation SHO<sup>1</sup> (RG04-113, RG04-127 & RG05-20). 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>

<http://www.cboe.org/publish/RegCir/RG05-020.pdf>

### KEY POINTS

1. A pilot program established by the Securities and Exchange Commission ("SEC") to allow short sales of a limited number of stocks without regard to any price test will commence on May 2, 2005, and end on April 28, 2006.<sup>2</sup>
2. Under the pilot program, the SEC determined to temporarily suspend short sale price tests, including any SRO imposed price tests, for 986 stocks selected from among stocks in the Russell 3000 Index as of June 25, 2004, and specifically identified in the SEC's order (Category A Pilot Securities – no price test at any time).

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<sup>1</sup> 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](http://www.sec.gov/rules/final/34-50103.htm).

<sup>2</sup> The SEC's orders concerning the pilot program are found in Exchange Act Release No. 34-50104 (July 28, 2004), 69 FR 48032 (August 6, 2004) and Exchange Act Release No. 34-50747 (November 29, 2004), 69 FR 70480 (December 6, 2004).

3. In addition, the SEC has temporarily suspended all short sale price tests for any stock in the Russell 1000 Index as of June 25, 2004 (not included in the Category A Pilot Securities) from 4:15 PM ET until the opening of the consolidated tape the following day (Category B Pilot Securities – no price test from 4:15 PM ET until 4:00 AM ET next day).
4. Additionally, under the SEC's order, there will be no price test for any securities when the consolidated tape is closed (Category C Pilot Securities – no price test from 8:00 PM ET until 4:00 AM ET next day).
5. A list of Category A Pilot Securities as of April 13, 2005, may be found on the SEC's website at:  
[www.sec.gov/spotlight/shopilot/currentpilota41305.txt](http://www.sec.gov/spotlight/shopilot/currentpilota41305.txt).  
A list of Category B Pilot Securities as of April 13, 2005, may be found on the SEC's website at:  
[www.sec.gov/spotlight/shopilot/currentpilotb41305.txt](http://www.sec.gov/spotlight/shopilot/currentpilotb41305.txt).
6. Both of the above-referenced lists have been updated by the SEC as of April 13, 2005, to reflect name changes and mergers and acquisitions since the SEC first compiled them on June 25, 2004.
7. Name changes of securities included in the pilot will not affect their status. Going forward, mergers and acquisitions can affect pilot status.
8. The following examples demonstrate how mergers and acquisitions will generally be handled:
  - merger of two Category A Pilot Securities - resulting security will be a Category A Pilot Security
  - merger of a Category A Pilot Security and a Category B or Category C Pilot Security - resulting security will have the same pilot category status as the security of the corporation that had the largest market capitalization as of the close of trading on the day before the merger was announced
9. When the pilot commences on May 2, 2005, the New York Stock Exchange, American Stock Exchange and NASD will be responsible for monitoring Category A and B Pilot Securities for name changes and mergers and acquisitions. Each organization will monitor only the stocks for which it is the primary listing market and maintain an up-to-date listing of those stocks on its website. The websites are as follows:

[www.nyse.com/regshopilot](http://www.nyse.com/regshopilot)

[www.amex.com.amextrader](http://www.amex.com.amextrader)  
[www.nasdaqtrader.com/trader/tradingservices.mktregulation.stm#regsho](http://www.nasdaqtrader.com/trader/tradingservices.mktregulation.stm#regsho)

10. The SEC has issued a no-action letter concerning pilot securities and the Regulation SHO requirement to mark a short sale order “short exempt” when relying on an exemption from a price test. The letter provides that the SEC will not recommend enforcement action if short sales in pilot securities are marked “short” rather than “short exempt.” The no-action letter may be found on the SEC’s website at:  
[www.sec.gov/divisions/marketreg/mr-noaction/sia041505.htm](http://www.sec.gov/divisions/marketreg/mr-noaction/sia041505.htm).
11. Based on the letter, short sales of pilot securities can be marked “short” rather than “short exempt” provided the order is routed to a market center that:
- has instituted procedures to mask (i.e., remove) the short sale character of such transactions so that they are executed without regard to the applicable price test;
  - reactivates the price test if the security ceases to be included in the pilot; and
  - makes, keeps and furnishes promptly upon request, the books and records of such activities as required under applicable rules and regulations.
12. Additionally, the no-action letter requires that short sales eligible for the relief must be marked “short” and may not be marked “long.”

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The SEC has prepared a in-depth explanation of the pilot program, including responses to frequently asked questions, which may be found on the SEC’s website at: [www.sec.gov/spotlight/shopilot.htm](http://www.sec.gov/spotlight/shopilot.htm).

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 Member Firm Regulation.