



Regulatory Circular RG08-126

To: Members

From: Division of Member and Regulatory Services

Date: October 2, 2008

Re: Extension of SEC Emergency Orders Concerning Short Selling

Yesterday the SEC announced the extension of the short sale emergency orders. The SEC press release announcing the extensions is available at <http://www.sec.gov/news/press/2008/2008-235.htm>. The extension of the September 17, 2008 emergency order (which, among other things, adopted temporary Rule 204T) is available at <http://www.sec.gov/rules/other/2008/34-58711.pdf>.

In relevant part, the SEC extended the following:

- **Temporary Prohibition of Short Selling in Financial Companies.** On September 18, 2008, the SEC adopted, on an emergency basis, an order prohibiting short sales in certain financial securities (subject to certain exceptions). This order will be extended beyond its currently scheduled expiration of October 2, 2008, to allow time for completion of work on legislation designed to ease the effects of the ongoing credit crisis. It will expire at 11:59 p.m. ET on the third business day after enactment of the legislation, but in any case no later than 11:59 p.m. ET on October 17, 2008.
- **Rule 204T, Options Market Maker Threshold Security Hedge Exception and Anti-Fraud Rule:** The SEC took action on September 17, 2008 in a separate emergency order. Each of the actions under that order will continue in force following expiration of the SEC's emergency orders. These actions include the following:
 - **Hard T+3 close-out requirement for naked short selling; penalties for violation include prohibition of further short sales without mandatory pre-borrow.** The SEC adopted, on an emergency basis, a new rule requiring that short sellers and their broker-dealers deliver securities by the settlement date (three days after the sale transaction date, or T+3) and imposing penalties for failure to do so. If a short sale violates this close-out requirement, then any broker-dealer acting on the short seller's behalf will be prohibited from further short sales in the same security unless the shares are not only located but also pre-borrowed. The prohibition on the broker-dealer's activity applies not only to short sales for the particular

naked short seller, but to all short sales for any customer. The emergency order will be extended, and will now expire at 11:59 p.m. ET on October 17, 2008, but the SEC intends that the order will continue in effect beyond that date without interruption in the form of an interim final rule. The SEC will seek comments on all aspects of the anticipated rulemaking. We note that the SEC Staff guidance regarding the order that addressed current and anticipated technical and operational concerns regarding the requirements of the order will also continue to apply for the duration of the order, and the Commission adopted and incorporated the guidance into the order. This guidance is available at <http://www.sec.gov/divisions/marketreg/204tfaq.htm> and <http://www.sec.gov/divisions/marketreg/loanedsecuritiesfaq.htm>.

- **Repeal of exception for options market makers from short selling close-out provisions in Regulation SHO.** This exception had permitted options market makers to maintain fail positions indefinitely. It was repealed effective at 12:01 a.m. ET on September 18, 2008, through a final rule to eliminate the options market maker exception from the close-out requirement of Rule 203(b)(3) in Regulation SHO.
- **Rule 10b-21 naked short selling anti-fraud rule.** The rule, which became effective at 12:01 a.m. ET on September 18, 2008, covers short sellers who deceive broker-dealers or any other market participants about their intention or ability to deliver securities in time for settlement. The rule makes clear that such persons are violating the law when they fail to deliver.

We understand there may be questions related to this news. We will issue further guidance as we learn more. CBOE Staff is also compiling a list of issues that our members have raised regarding the rulemaking. Please forward any questions to Jim Adams at adamsj@cboe.com or 312-786-7718 or Jennifer Lamie at lamie@cboe.com or 312-786-7576.