



To: Members

From: Division of Member and Regulatory Services

Date: September 18, 2008

Re: SEC Issues New Rules Regarding Short Sales (UPDATE)  
Emergency Order Now Available

Yesterday evening, the SEC issued a temporary, emergency order (Order) detailing the particular actions it has taken with respect to short sales. The Order is available at <http://www.sec.gov/rules/other/2008/34-58572.pdf>. We are still analyzing the Order, but below are some highlights:

- The Order became effective today and terminates at 11:59 pm on October 1, 2008, unless further extended (an extension of an emergency order may last a maximum of 30 days from the Order date).
- The options market maker (OMM) hedge exception to the threshold security close-out and pre-borrow requirements has been eliminated. Previously excepted positions in threshold securities now have to be closed out within 35 consecutive settlement days of the Order's effective date. For fails persisting beyond 35 days, the clearing firm and any BD for which it clears, including any OMMs, become subject to a pre-borrow requirement.
- Transactions that occurred before the Order became effective are not subject to the Order's delivery requirement (discussed below). However, they remain subject to the existing threshold security close-out and pre-borrow requirements.
- For long and short sale transactions in all equity securities that occur after the Order became effective, there is a hard T+3 delivery requirement. In addition:
  - Unless a pre-borrow requirement has been imposed due to a fail to deliver, the *bona fide* market maker exception from the requirement to perform a locate or pre-borrow prior to effecting a short sale still applies.
  - If there is a fail to deliver, a close-out requirement applies.<sup>1</sup>
  - If the fail position is not closed out by the required time, then the clearing firm and any broker-dealer (BD) for which it clears, including any OMMs, are subject to a pre-borrow requirement in the particular security where the fail exists. The pre-borrow requirement will be in effect until the fail is closed and has cleared and settled.
  - The clearing firm must notify any BD for whom it clears, including any OMM, of any fails that have not been closed out and when the purchase to close out the fail position has cleared and settled.
- There is a new "naked" short selling antifraud rule. Under the rule, a violation occurs if any person submits an order to sell a security, misleads a BD, clearing firm, or purchaser about the seller's intention or ability to deliver on or before the settlement date and then fails to deliver.

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<sup>1</sup> The clearing firm must close out the position no later than the beginning of regular trading hours on the following settlement date (T+4), provided, however, longer close out periods are available for certain fails.

Overview of the Order's Delivery, Close-Out and Pre-Borrow Requirements:

Activity	Impact of Order on Options Market Maker (OMM)	Impact of Order on Other Market Participants
Sale of any equity security that occurred <u>before</u> the effective date of the Order	The T+3 delivery requirement does not apply.	The T+3 delivery requirement does not apply.
Fail position in a <u>non-threshold security</u> resulting from a sale that occurred <u>before</u> the effective date of the Order	No close-out or pre-borrow requirement.	No close-out or pre-borrow requirement.
Fail position in a <u>threshold security</u> resulting from a sale that occurred <u>before</u> the effective date of the Order	Fail positions in threshold securities associated with the OMM hedge exception must be closed out in 35 consecutive settlement days and a pre-borrow requirement applies if the fail persists.  Fails not associated with the exception are subject to close-out and pre-borrow requirements for fails that persist for 13 consecutive settlement days.	Fail positions are subject to close-out and pre-borrow requirements for fails that persist for 13 consecutive settlement days.
Sale of <u>any</u> equity security that occurs <u>after</u> the effective date of the Order	Delivery is required by T+3. Unless a pre-borrow requirement has been imposed due to a fail to deliver, the <i>bona fide</i> market maker exception from the requirement to perform a locate or pre-borrow prior to effecting a short sale is still effective.	Delivery is required by T+3. Unless a pre-borrow requirement has been imposed due to a fail to deliver, a locate or pre-borrow must be performed prior to effecting a short sale.
Fail position in <u>any</u> equity security resulting from a sale that occurs <u>after</u> the effective date of the Order	If delivery does not occur on T+3, certain close-out and pre-borrow requirements apply.	If delivery does not occur on T+3, certain close-out and pre-borrow requirements apply.

Any questions on this circular may be directed to Jim Adams at [adamsj@cboe.com](mailto:adamsj@cboe.com) or 312-786-7718 or Jennifer Lamie at [lamie@cboe.com](mailto:lamie@cboe.com) or 312-786-7576.

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