

Recent SEC Actions Regarding Short Sales

September 23, 2008

In response to recent stock market volatility, the Securities and Exchange Commission has adopted sweeping orders with respect to short sales. These orders are currently scheduled to terminate on October 2, 2008 but may be extended at the discretion of the SEC. The SEC has already amended some of these orders and may adopt further amendments as it responds to queries from market participants. We note that there remain a number of matters for which the securities industry continues to seek clarification, and we expect further guidance as the week progresses.

Temporary Requirements for Institutional Investment Managers to Disclose Short Sales Activity

On September 18, 2008, the SEC announced temporary disclosure requirements for institutional investment managers that filed or were required to file a Form 13F for the calendar quarter ended June 30, 2008.¹ Specifically, each such institutional investment manager must file a report on new Form SH² on the first business day of every calendar week immediately following a week in which it effects short sales³ with respect to any 13F security⁴ that is not an option. A manager must file a Form SH report with the SEC via EDGAR on or before 5:30 p.m. Eastern Time on the first business day of each week immediately following the preceding seven calendar day period in which the manager has effected any short sales reportable on Form SH.

¹ See [Exchange Act Release No. 58591](#) (September 18, 2008).

² See [Form SH](#) and [Form SH Instructions](#) available on the SEC website. A Microsoft Word version of [Form SH](#) is also available on the SEC website.

³ The term "short sale" means "any sale of a security which the seller does not own or any sale which is consummated by the delivery of a security borrowed by, or for the account of, the seller" (Rule 200(a) of Regulation SHO). For purposes of Regulation SHO, "a person shall be deemed to own securities only to the extent that he has a net long position in such securities" (Rule 200(c) of Regulation SHO). A "short sale against the box" occurs when a seller actually owns the stock but settles the sale with borrowed shares. A sale in connection with the establishment of a boxed position or the sale of the long portion of a boxed position would each constitute a short sale for purposes of Regulation SHO.

⁴ In determining which securities are 13F securities, institutional investment managers may rely on the list of such securities made available on the SEC's website (Rule 13f-1(c) under the Securities Exchange Act of 1934). Generally, the list includes exchange-traded or NASDAQ-quoted stocks, equity options and warrants, shares of closed-end investment companies, certain convertible debt securities and shares of exchange-traded funds. See [Division of Investment Management: Frequently Asked Questions About Form 13F](#) (May 2005).

Effective September 22, 2008, the SEC amended its September 18 order to provide that information disclosed on Form SH will be non-public for two weeks after the Form SH is electronically filed with the SEC.⁵ The Form SH instructions provide for the addition of the phrase **NON-PUBLIC** (in bold and capital letters) at the top and bottom of each page of the Form SH (the Cover Page, the Summary Page and the Information Table).

The earliest date on which any Form SH filings are due will be Monday, September 29, 2008. Form SH filings due on September 29, 2008 must contain information regarding short sales during the seven calendar day period beginning Monday, September 22, 2008. A 13F filer will not have Form SH filing obligations unless it has engaged in short sales of 13F securities during the previous week.

An investment manager must include the following information on Form SH:

- The number and value of such security;
- The opening short position⁶ and closing short position in such security; and
- The largest intraday short position, and the time of the largest intraday short position, in such security during each calendar day of the prior week.⁷

Investment managers should note that they are not required to report short positions with respect to a 13F security that would otherwise be reportable if they meet the following de minimis exception, which is calculated by totaling the number of securities sold short each day and multiplying that total by the closing price for the security on that day:

- The short position constitutes less than one-quarter of one per cent (0.25%) of the class of the issuer's 13F securities issued and outstanding as reported on the issuer's most recent annual or quarterly report, and any current report subsequent thereto (unless the investment manager knows or has reason to believe that the information contained therein is inaccurate); and

⁵ See [Exchange Act Release No. 58591A](#) (September 21, 2008).

⁶ The position reported will only reflect trades effected on or after September 22, 2008. Pursuant to the Form SH instructions, the start of day position in column 3 for September 22, 2008 will be zero for all securities. All positions existing prior to September 22, 2008 are considered to be "grandfathered" from Form SH reporting requirements. Accordingly, Form SH filings will reflect only short sale trades effected on or after September 22, 2008 rather than overall short sale positions of filers. The SEC has indicated that filers should not net long and short positions; rather, Form SH should report gross short positions.

⁷ Because many investment managers do not routinely compile such intra-day trading information, this is one of the more onerous aspects of Form SH as currently constituted.

- The fair market value of the short position is less than \$1,000,000.

Temporary Prohibition on Short Sales of Financial Institution Securities

On September 18, 2008, the SEC issued an emergency order temporarily prohibiting any person from effecting a short sale in the publicly traded securities of financial firms identified by the SEC in Appendix A to the order.⁸ On September 21, 2008, the SEC amended this order to provide that, in replacement of the list of firms on Appendix A to the original order, each national securities exchange that lists financial institutions for trading will publish a list, on its Internet website, identifying companies with common equity that will be covered by the order's prohibition on short sales.⁹ The SEC expects such companies to include banks, savings associations, broker-dealers, investment advisers, domestic and foreign insurance companies and the owners of any of the foregoing entities. A company that chooses not to be covered by the short sale prohibitions may be excluded from the list of covered companies published by the applicable national securities exchange.

The September 21 amendments also expanded some of the exceptions available under the September 18 order. The SEC expanded the exception for market makers to allow short sales in covered securities by any market maker, including over-the-counter market makers¹⁰, and specified that the exception extends to bona fide market making in exchange traded funds and exchange traded notes of which covered securities are a component. The SEC also clarified that the order does not prohibit (1) short sales that occur in connection the automatic exercise or assignment of equity options or the settlement of futures contracts due to the expiration of such positions that were held prior to the effectiveness of the order, (2) short sales by the writer of a long call option that occur as a result of assignment following exercise by the holder of the call option or (3) sales pursuant to Rule 144 of the Securities Act of 1933.

⁸ See [SEC Release No. 34-58592](#) (September 18, 2008), Simpson Thacher & Bartlett LLP Client Memorandum, "[Securities and Exchange Commission Issues Emergency Order Prohibiting Short Sales of Securities of Financial Institutions](#)" (September 19, 2008) and Simpson Thacher & Bartlett LLP Client Memorandum, "[Securities and Exchange Commission Amends Emergency Order Prohibiting Short Sales of Securities of Financial Institutions](#)" (September 22, 2008).

⁹ Lists of covered securities are available at the following websites: NYSE (http://www.nyse.com/attachment/NYSE_SS_ORDERUPDATED.xls) and NASDAQ (http://www.nasdaqtrader.com/content/newsalerts/2008/regulatoryalerts/nq_ss_092208.xls).

¹⁰ This exception is not available if the market maker knows that its customer's or counterparty's transaction will establish or increase an economic net short position for such party (including through synthetic positions). Each market maker relying on this exception must publish a notice on its Internet website stating that it may not knowingly effect a short sale in a manner prohibited by the order.

This memorandum is for general information purposes and should not be regarded as legal advice. Please contact your relationship partner if we can be of assistance regarding these important developments. The names and office locations of all of our partners, as well as memoranda regarding recent corporate reporting and governance developments, can be obtained from our website, www.simpsonthacher.com.