

FS Regulatory Briefs*

SEC's Emergency Order to Limit Short Selling in Certain Financial Entities - Updated

Richard Paulson, Director

David Sapin, Principal

Target Audience: Broker/Dealers

On July 15, 2008, the SEC issued an Emergency Order mandating new short sale requirements for market participants, effective July 21, 2008. This change restricts short sales in specified securities unless a "person" or its agent has borrowed or arranged to borrow the security or otherwise has the security available to borrow in inventory. The Order impacts short selling in the stock of the 19 financial services issuers listed below through trading on August 12, 2008. The SEC issued an Amendment to the Order on July 18, 2008, addressing some of the industry feedback generated by the Order. Additionally, the Staff of the SEC's Division of Trading and Markets published guidance concerning the implementation of the Order. Lastly, on July 29, 2008, the SEC extended the Order through August 12, 2008. The SEC is currently considering a rulemaking related to short selling, as this Order cannot be extended beyond August 12th.

The issuers affected by the Order are: BNP Paribas Securities Corp., Bank of America Corporation, Barclays PLC, Citigroup Inc., Credit Suisse Group, Daiwa Securities Group Inc., Deutsche Bank Group AG, Allianz SE, Goldman Sachs Group Inc, Royal Bank ADS, HSBC Holdings PLC ADS, J.P. Morgan Chase & Co., Lehman Brothers Holdings Inc., Merrill Lynch & Co., Inc., Mizuho Financial Group, Inc., Morgan Stanley, UBS AG, Freddie Mac and Fannie Mae.

Unprecedented Action

This action reflects the SEC's concern that naked short selling, in conjunction with market rumors, are exacerbating market volatility, particularly in the stock of financial services firms. The Commission believes that this action will eliminate any possibility that naked short selling is responsible for downward pressure on these particular issuer's securities.

Based on our review of the Order, the Amendment and the related guidance and numerous discussions with industry contacts and

clients, the following points of clarification and points of consideration have emerged. We encourage you to consider them as you execute your firm's plan to comply with the Order.

Points of Clarification

- The borrow or arrangement to borrow requirement does not apply to market makers (although the settlement delivery date requirement does) that are selling affected securities short as part of bona fide market making and hedging activities.
- Market participants may document the borrow or the arrangement to borrow required by the Order utilizing the same policies and procedures that they currently use to document compliance with the locate requirement set forth by Rule 203(b)(1)(i) of Regulation SHO (assuming those practices are compliant with Regulation SHO).
- Short sales executed pursuant to Rule 144 of the '33 Act are exempt from compliance with the Order.
- Short sales by an underwriter or any member of a syndicate or selling group are also exempt from compliance with the Order.
- To comply with the Commission's "arrangement to borrow" standard, market participants need a bona fide agreement to borrow such that, at the time of the agreement, the security borrowed is assigned solely to the borrower. As a

result, large custodians and other lenders should evaluate whether their existing systems permit for the assignment of shares.

- Although a person may rely on a customer's representation that the customer has arranged to borrow the security from another identified source, the person effecting the short sale must document that it 1) is relying on the customer's assurance and 2) has reasonable grounds to believe that the customer has borrowed or arranged to borrow the security. Market participants should verify that their policies and procedures are consistent with this guidance when relying on a customer's assurance.
- If a person borrows or arranges to borrow an affected security consistent with the Order and then executes a short sale that is subsequently closed intra day, the person may go short again on the same borrow or arrangement to borrow without re-establishing the borrow. Importantly however, the amount of shares must be equal to or less than the original borrow.
- Market participants that may attempt to execute and/or book short sales outside of the United States should consider that the Order applies to any short sale transaction if the trade is agreed to in the United States or if the customer is located in the United States, regardless of the trade's booking location.

Additional Points of Consideration

- Brokers that utilize so called "easy to borrow" lists should remove the 19 issuers in the Order from these lists.
- Market participants should review all policies and procedures governing short sales, including those regarding each Direct Market Access platform, to ensure compliance with the Order.
- Carrying and clearing firms should advise their introducing brokers of any short sale policy changes and consider

measures to ensure introducing firms comply with new requirements.

- While questions still remain as to the need to actually deliver borrowed securities on certain transactions in the affected securities (e.g., on short sales covered before settlement date), firms should be prepared to do so.
- Market participants should immediately consult with technology, operations, vendors, and executing brokers to assess any necessary system changes.
- Market participants should administer training on any new procedures to sales and trading, operations and middle and back office personnel.
- In addition to advising on each of the above steps, the compliance department should develop additional surveillance review methodologies to test for adherence to the new Order.

Firms should thoroughly document all actions taken to comply with this directive as the likelihood of SEC examinations around this issue is high. We will continue to monitor regulatory activity in this area and will communicate any key developments to our clients. If you have any questions in the interim, please contact the individuals identified below.

Additional Information

If you would like additional information about the topic discussed in this FS Regulatory Brief, please call:

Richard Paulson, Director	646-471-2519
Daniel Ryan, Partner	646-471-8488
David Sapin, Principal	703-918-1391

www.pwc regulatory.com

© 2008 PricewaterhouseCoopers LLP. All rights reserved. "PricewaterhouseCoopers" refers to PricewaterhouseCoopers LLP or, as the context requires, the PricewaterhouseCoopers global network or other member firms of the network, each of which is a separate and independent legal entity. The information contained in this document is for general guidance on matters of interest only. The application and impact of laws can vary widely based on the specific facts involved. Given the changing nature of laws, rules and regulations, there may be omissions or inaccuracies in information contained in this document. Before making any decision or taking any action, you should consult a competent professional adviser. Although we believe that the information contained in this document has been obtained from reliable sources, PricewaterhouseCoopers is not responsible for any errors or omissions contained herein or for the results obtained from the use of this information.