SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 242

[Release No. 34–59748; File No. S7–08–09]

RIN 3235–AK35

Amendments to Regulation SHO

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: The Securities and Exchange Commission (''Commission'') is proposing amendments to Regulation SHO under the Securities Exchange Act of 1934 (''Exchange Act''). We are proposing two approaches to restrictions on short selling—one is a price test that would apply on a market wide and permanent basis (''short sale price test'' or ''short sale price test restriction'') and one that would apply only to a particular security during severe market declines in that security (''circuit breaker''). With respect to the first approach, we propose two alternative short sale price tests: One based on the national best bid and the second based on the last sale price. With respect to the second approach, we propose two basic alternatives: One alternative is a circuit breaker rule that would temporarily prohibit short selling in a particular security when there is a severe decline in the price of that security (a ''halt''), which could operate in place of, or in addition to, a short sale price test rule; and the second alternative is a circuit breaker rule that would trigger a short sale price test rule; we propose that such a short sale price test either be based on the national best bid for any security for which there has been a severe price decline or be based on the last sale price for any security for which there has been a severe price decline.

Due to the extreme market conditions that we are currently facing and the resulting deterioration in investor confidence, we believe it is appropriate at this time to re-evaluate and seek comment on some form of short sale price test restriction, either in the form of a short sale price test such as the proposed modified uptick rule or proposed uptick rule, or a circuit breaker rule.

For each of the proposed short sale price test restrictions and proposed circuit breaker rules, we are also proposing to amend Regulation SHO to require that a broker-dealer mark certain sell orders ''short exempt.'' If the Commission adopts a short sale price test proposal or a circuit breaker proposal, and adopts a ''short exempt'' marking requirement, we are proposing that the implementation period for these amendments would be three months from the effective date of the amendments.

DATES: Comments should be received on or before June 19, 2009.

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic Comments

- Use the Commission's Internet comment form (*http://www.sec.gov/rules/proposed.shtml*); or
- Send an e-mail to *rule-comments@sec.gov.* Please include File Number S7–08–09 on the subject line; or
- Use the Federal eRulemaking Portal (*http://www.regulations.gov*). Follow the instructions for submitting comments.

Paper Comments

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549–1090.

All submissions should refer to File Number S7–08–09. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (*http://www.sec.gov/rules/final.shtml*). Comments are also available for public inspection and copying in the Commission's Public Reference Room, 100 F Street, NE., Washington, DC 20549, on official business days between the hours of 10 am and 3 p.m. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT: James Brigagliano, Deputy Director; Jo Anne Swindler, Acting Associate Director; Josephine Tao, Assistant Director; Victoria Crane, Branch Chief; Joan Collopy, Special Counsel; Christina Adams, Special Counsel; or Matthew Sparkes, Staff Attorney, Division of Trading and Markets, at (202) 551–5720, at the Commission, 100 F Street, NE., Washington, DC 20549–6628.

SUPPLEMENTARY INFORMATION: The Commission is requesting public comment on proposed amendments to Rules 200(g) and 201 of Regulation SHO, 17 CFR 242.200(g) and 17 CFR 242.201, under the Exchange Act. The Commission is soliciting comments on all aspects of the proposed amendments.

I. Executive Summary

In July 2007, the Commission eliminated all short sale price test restrictions. At that time, short sale price test restrictions included Rule 10a–1 under the Exchange Act, also known as the ''uptick rule'' or ''tick test'' (''former Rule 10a–1''), that applied to exchange-listed securities, and the National Association of Securities Dealers, Inc.'s (''NASD'') [1] bid test, that applied to certain Nasdaq securities. The Commission's removal of short sale price test restrictions followed a careful, deliberative rulemaking process, carried out in multiple stages from 1999 through 2006, and was open to the public at every stage.[2]

Prior to taking that action, the Commission took a number of steps, including seeking extensive public comment and staff study to consider removing short sale price test restrictions. For example, beginning in 1999, the Commission published a concept release in which it sought comment regarding short sale price test regulation, including on whether to eliminate such regulation.[3] In 2004, the Commission initiated a year-long pilot to study the removal of short sale price tests for approximately one-third of the largest stocks.[4] Short sale data was made publicly available during this pilot to allow the public and Commission staff to study the effects of eliminating short sale price test restrictions. The findings of third party researchers were presented and discussed in a public Roundtable in September 2006.[5] In addition, the results of the Commission staff study of the pilot data were made publicly available in draft form in September 2006 and in final form in February 2007.[6]

[1] NASD is now known as the Financial Industry Regulatory Authority, Inc. (''FINRA'').

[2] In 1999, the Commission published a concept release in which it sought comment regarding short sale price test regulation, including on whether to eliminate such regulation. *See* Securities Exchange Act Release No. 42037 (Oct. 20, 1999), 64 FR 57996 (Oct. 28, 1999).

[3] *See* Securities Exchange Act Release No. 42037 (Oct. 20, 1999), 64 FR 57996 (Oct. 28, 1999).

[4] *See* Securities Exchange Act Release No. 50104 (July 28, 2004), 69 FR 48032 (Aug. 6, 2004) (''Pilot Release'').

[5] *See http://www.sec.gov/about/economic/shopilottrans091506.pdf.*

[6] *See http://www.sec.gov/about/economic/shopilot091506/draft_reg_sho_pilot_report.pdf* and *http://www.sec.gov/news/studies/2007/regshopilot020607.pdf. See also* discussion of findings of staff study, *supra* notes 25 to 41 and accompanying text.

As discussed in detail below,[7] concurrent with the development of the subprime mortgage crisis and credit crisis in 2007, market volatility, including steep price declines, particularly in the stocks of certain financial services issuers, has increased markedly in the U.S. and in every major stock market around the world (including markets that continued to operate under short sale price test restrictions). As market conditions have continued to worsen, investor confidence has eroded, and the Commission has received requests from many commenters to consider imposing restrictions with respect to short selling, in part in the belief that such action would help restore investor confidence.

Due to the extreme market conditions that we are currently facing and the resulting deterioration in investor confidence, we believe it is appropriate at this time to re-examine and seek comment on whether to restore restrictions with respect to short selling. Thus, we are proposing two approaches to restrictions on short selling. One approach would apply a price test on a market wide and permanent basis. With respect to this approach, we propose two alternative price tests. The first alternative price test, in many ways similar to NASD's former bid test, would be based on the national best bid (the ''proposed modified uptick rule''). The second alternative price test, similar to former Rule 10a–1, would be based on the last sale price (the ''proposed uptick rule'').[8]

The other approach would apply only to a particular security during a severe market decline in that security (collectively, the ''proposed circuit breaker rules''). With respect to this second approach, we are proposing two basic alternatives. First, we propose a circuit breaker rule that, when triggered by a severe price decline in a particular security, would temporarily prohibit any person from selling short that security, subject to certain exceptions (''proposed circuit breaker halt rule''). The proposed circuit breaker halt rule could operate in place of, or in addition to, a short sale price test restriction. Second, we propose a circuit breaker rule that, when triggered by a severe price decline in a particular security, would trigger a temporary short sale price test for that security. In connection with this approach, we are proposing two price tests. One is the modified uptick rule—that is, we propose a circuit breaker rule that would, when triggered by a severe decline in a particular security, temporarily impose the proposed modified uptick rule for that security (''proposed circuit breaker modified uptick rule''). The other is the uptick rule—that is, we propose a circuit breaker rule that would, when triggered by a severe market decline in a particular security, temporarily impose the proposed uptick rule for that security (''proposed circuit breaker uptick rule''). A circuit breaker that triggers a short sale price test rule such as the proposed modified uptick rule or the proposed uptick rule would operate in place of a short sale price test rule (collectively, the ''circuit breaker price test rules'').

As discussed in detail below, we preliminarily believe that of the short sale price test proposals, a price test based on the national best bid would have advantages over a test based on the last sale price in today's markets. Among other reasons, we believe that bids generally are a more accurate reflection of current prices for a security than last sale prices due to delays that can occur in the reporting of last sale price information and the manner in which last sale price information is published to the markets. For example, sale transactions may be reported manually up to 90 seconds after they occur. Even sale transactions that are reported automatically can be reported out-of-sequence if trades are occurring in multiple trading venues. This may make the proposed uptick rule more difficult to implement. In addition, last sale price information is published to the markets in reporting sequence rather than in transaction sequence. Thus, we preliminarily believe that if we were to adopt a short sale price test restriction, whether as a full-time rule or as part of a circuit breaker rule, that it would be more appropriate for such short sale price test restrictions to be based on the national best bid rather than on the last sale price.

A short sale price test similar to former Rule 10a–1 that is based on the last sale price, a short sale price test based on a national best bid, and a circuit breaker rule resulting in a short sale halt, should generally be familiar to investors and market participants. Former Rule 10a–1 was in place for almost 70 years. NASD adopted its bid test in 1994 and that rule was in place for over a decade. Various circuit breaker rules have been in place throughout the markets for many years.[9] A circuit breaker rule resulting in a short sale price test for particular stocks that have suffered a severe price decline would be an amalgamation of these familiar rules.

To offer straight-forward alternatives, this release proposes a modified uptick rule based on the national best bid that would apply to trading centers[10] and applies a policies and procedures approach that would require that trading centers have policies and procedures reasonably designed to prevent the execution or display of short sales at impermissible prices. As an alternative short sale price test, this release proposes an uptick rule based on the last sale price that, similar to former Rule 10a–1, applies a straight prohibition approach that would prohibit any person from effecting short sales at impermissible prices. However, either alternative could ultimately be implemented through a policies and procedures approach or through a prohibition approach or some combination thereof.[11]

We are also proposing circuit breaker rules.[12] As noted above, these are the proposed circuit breaker halt rule, the proposed circuit breaker modified uptick rule, and the proposed circuit breaker uptick rule. In addition, we are proposing that a broker-dealer be required to mark a sell order ''short exempt'' if the seller is relying on an exemption under the proposed short sale price test rules or proposed circuit breaker rules.

II. Background on Short Sale Restrictions

Short selling involves a sale of a security that the seller does not own or a sale that is consummated by the delivery of a security borrowed by, or for the account of, the seller.[13] In order

[7] *See infra* Section II(C).

[8] In 2003, the Commission proposed a short sale price test based on the national best bid (''uniform bid test''). *See* Securities Exchange Act Release No. 48709 (Oct. 28, 2003), 68 FR 62972 (Nov. 6, 2003) (''2003 Regulation SHO Proposing Release''). The Commission determined not to proceed with the uniform bid test, but instead established a pilot program pursuant to which it could evaluate the overall effectiveness of short sale price test restrictions on short sales. *See* Securities Exchange Act Release No. 50103 (July 28, 2004), 69 FR 48008, 48009 (Aug. 6, 2004) (''2004 Regulation SHO Adopting Release''). *See also infra* Section II(B) (discussing the pilot program).

[9] *See, e.g., infra* note 239 and accompanying text.

[10] A ''trading center'' means a national securities exchange or national securities association that operates an SRO trading facility, an alternative trading system, an exchange market maker, an OTC market maker, or any other broker or dealer that executes orders internally by trading as principal or crossing orders as agent. *See infra* note 111 and supporting text.

[11] For instance, the approaches could be combined so that persons are prohibited from selling short on a downbid and trading centers are also required to have reasonable policies and procedures to prevent the execution or display of a short sale on a downbid.

[12] *See* Section III.C below discussing the proposed circuit breaker rules.

[13] *See* 17 CFR 242.200(a).

to deliver the security to the purchaser, the short seller will borrow the security, typically from a broker-dealer or an institutional investor. Typically, the short seller later closes out the position by purchasing equivalent securities on the open market and returning the security to the lender. In general, short selling is used to profit from an expected downward price movement, to provide liquidity in response to unanticipated demand, or to hedge the risk of an economic long position in the same security or in a related security.[14]

A. Short Selling and Its Market Impact

The Commission has long held the view that short selling provides the market with important benefits, including market liquidity and pricing efficiency.[15] Market liquidity is often provided through short selling by market professionals, such as market makers (including specialists) and block positioners, who offset temporary imbalances in the buying and selling interest for securities. Short sales effected in the market add to the selling interest of stock available to purchasers and reduce the risk that the price paid by investors is artificially high because of a temporary imbalance between buying and selling interest. Short sellers covering their sales also may add to the buying interest of stock available to sellers.[16]

Short selling also can contribute to the pricing efficiency of the equities markets.[17] When a short seller speculates or hedges against a downward movement in a security, his transaction is a mirror image of the person who purchases the security in anticipation that the security's price will rise or to hedge against such an increase. Both the purchaser and the short seller hope to profit, or hedge against loss, by buying the security at one price and selling at a higher price. The strategies primarily differ in the sequence of transactions. Market participants who believe a stock is overvalued may engage in short sales in an attempt to profit from a perceived divergence of prices from true economic values. Such short sellers add to stock pricing efficiency because their transactions inform the market of their evaluation of future stock price performance. This evaluation is reflected in the resulting market price of the security.[18]

We recognize that, to the extent that the proposed short sale price test restrictions would result in increased costs to short selling in equity securities, it may lessen some of the benefits of legitimate short selling. Such a reduction may lead to a decrease in market efficiency and price discovery, less protection against upward stock price manipulations, a less efficient allocation of capital, an increase in trading costs, and a decrease in liquidity. Thus, we believe there may be potential costs associated with the proposed short sale price tests in terms of potential impact of such price tests on quote depths, spread widths, and market liquidity. We also believe costs may be incurred in terms of execution and pricing inefficiencies. For example, requiring all short sale orders to be executed or displayed above the best bid, or last sale price, in a declining market may slow the speed of executions and impose additional costs on market participants, including buyers. Also, by not allowing short sellers to sell at the bid, or last sale price, the proposed short sale price tests may impede trading and distort market pricing.

Although short selling serves useful market purposes, it also may be used to illegally manipulate stock prices.[19] One example is the ''bear raid'' where an equity security is sold short in an effort to drive down the price of the security by creating an imbalance of sell-side interest.[20] This unrestricted short selling could exacerbate a declining market in a security by increasing pressure from the sell-side, eliminating bids, and causing a further reduction in the price of a security by creating an appearance that the security price is falling for fundamental reasons, when the decline, or the speed of the decline, is being driven by other factors.[21]

B. History of Short Sale Price Test Restrictions in the U.S.

Section 10(a) of the Exchange Act[22] gives the Commission plenary authority to regulate short sales of securities registered on a national securities exchange, as necessary or appropriate in the public interest or for the protection of investors.[23] After conducting an inquiry into the effects of concentrated short selling during the market break of 1937,[24] the Commission adopted former Rule 10a–1 (also known as the ''tick test'' or ''uptick rule'') in 1938 to restrict short selling in a declining market.[25]

The core provisions of former Rule 10a–1 remained virtually unchanged for almost 70 years. Over the years, however, in response to changes in the securities markets, including changes in trading strategies and systems used in the marketplace, the Commission added exceptions to former Rule 10a–1 and granted numerous written requests for relief from the rule's restrictions. These market changes included decimalization, the increased use of matching systems that execute trades at independently derived prices during random times within specific time intervals,[26] and the spread of fully automated markets. In addition, market developments over the years led to the application of different price tests to securities trading in different markets.[27]

[14] *See, e.g.,* Securities Exchange Act Release No. 54891 (Dec. 7, 2006), 71 FR 75068, 75069 (Dec. 13, 2006) (''2006 Price Test Elimination Proposing Release''); 2003 Regulation SHO Proposing Release, 68 FR at 62974.

[15] *See id. See also* Securities Exchange Act Release No. 29278 (June 7, 1991), 56 FR 27280 (June 13, 1991); 2004 Regulation SHO Adopting Release, 69 FR 48008, n. 6; Boehmer, Ekkehart and Wu, Julie, *Short Selling and the Informational Efficiency of Prices* (Jan. 8, 2009).

[16] *See, e.g.,* 2006 Price Test Elimination Proposing Release, 71 FR at 75069; 2003 Regulation SHO Proposing Release, 68 FR at 62974.

[17] *See id.*

[18] *See id.* Arbitrageurs also contribute to pricing efficiency by utilizing short sales to profit from price disparities between a stock and a derivative security, such as a convertible security or an option on that stock. For example, an arbitrageur may purchase a convertible security and sell the underlying stock short to profit from a current price differential between two economically similar positions. *See id.*

[19] *See, e.g., U.S.* v. *Russo,* 74 F.3d 1383, 1392 (2d Cir. 1996) (short sales were sufficiently connected to the manipulation scheme as to constitute a violation of Exchange Act Section 10(b) and Rule 10b–5); *S.E.C.* v. *Gardiner,* 48 S.E.C. Docket 811, No. 91 Civ. 2091 (S.D.N.Y. March 27, 1991) (alleged manipulation by sales representative by directing or inducing customers to sell stock short in order to depress its price).

[20] Many people blamed ''bear raids'' for the 1929 stock market crash and the market's prolonged inability to recover from the crash. *See* 8 Louis Loss and Joel Seligman, Securities Regulation, section 8–B–3 (3d ed. 2006).

[21] *See* 2006 Price Test Elimination Proposing Release, 71 FR at 75069; 2003 Regulation SHO Proposing Release, 68 FR at 62074.

[22] 15 U.S.C. 78j(a).

[23] *See also* 2006 Price Test Elimination Proposing Release, 71 FR at 75068; 2003 Regulation SHO Proposing Release, 68 FR at 62973.

[24] The study covered two weekly periods, that of September 7–13, 1937, and that of October 18–23, 1937. *See* Securities Exchange Act Release No. 1548 (Jan. 24, 1938), 3 FR 213 (Jan. 26, 1938) (''Former Rule 10a–1 Adopting Release'').

[25] *See id.* Former Rule 10a–1 provided that, subject to certain exceptions, a listed security could be sold short (i) at a price above the price at which the immediately preceding sale was effected (plus tick), or (ii) at the last sale price if it was higher than the last different price (zero plus tick).

[26] *See, e.g.,* Letter from Larry E. Bergmann, Senior Associate Director, Division of Market Regulation, SEC, to Andre E. Owens, Schiff Hardin & Waite, dated April 23, 2003 (granting exemptive relief from former Rule 10a–1 for trades executed through an alternative trading system that matches buying and selling interest among institutional investors and broker-dealers at various set times during the day).

[27] *See, e.g.,* Securities Exchange Act Release No. 55245 (Feb. 5, 2007), 72 FR 6635 (Feb. 12, 2007). Former Rule 10a–1 applied only to short sale transactions in exchange-listed securities. In 1994, the Commission granted temporary approval to

In July 2004, the Commission adopted Rule 202T of Regulation SHO,[28] which established procedures for the Commission to temporarily suspend short sale price tests for a prescribed set of securities so that the Commission could study the effectiveness of these tests.[29] Pursuant to the process established in Rule 202T, the Commission issued an order creating a one year pilot (''Pilot'') temporarily suspending the tick test of former Rule 10a–1(a) and any price test of any exchange or national securities association for short sales of certain securities.[30] The Pilot was designed to assist the Commission in assessing whether changes to current short sale price test regulation were appropriate at that time in light of then-current market practices and the purposes underlying short sale price test regulation.[31]

OEA gathered the data made public during the Pilot, analyzed the data and provided the Commission with a summary report on the Pilot (''OEA Staff's Summary Pilot Report'').[32] The OEA Staff's Summary Pilot Report, which was made public, examined several aspects of market quality including the overall effect of price tests on short selling, liquidity, volatility and price efficiency.[33] The Pilot was also designed to allow the Commission and members of the public to examine whether the effects of short sale price tests were similar across stocks.[34]

As set forth in the OEA Staff's Summary Pilot Report, OEA found little empirical justification at that time for maintaining short sale price test restrictions, especially for actively traded securities. Amongst its results, OEA found that short sale price tests did not have a significant impact on daily volatility. However, OEA also found some evidence that short sale price tests dampened intraday volatility for smaller stocks.[35]

OEA also found that the Pilot data provided limited evidence that price test restrictions distort a security's price.[36] In addition, OEA found that price test restrictions resulted in an increase in quote depths.[37] Realized liquidity levels, however, were unaffected by the removal of short sale price test restrictions.[38] The Pilot data also provided evidence that short sale price test restrictions reduce the volume of executed short sales to total volume and, therefore, act as a constraint on short selling.[39] OEA did not find, however, a significant difference in short interest positions between those securities subject to a short sale price test versus those securities that were not subject to such a test during the Pilot.[40]

In addition, the Commission encouraged outside researchers to examine the Pilot data. In response to this request, the Commission received four completed studies (the ''Academic Studies'') from outside researchers that specifically examined the Pilot data.[41] The Commission also held a public roundtable (the ''Regulation SHO Roundtable'') that focused on the empirical evidence learned from the Pilot data (the OEA Staff's Summary Pilot Report, Academic Studies, and Regulation SHO Roundtable are referred to collectively herein as, the ''Pilot Results'').[42] The Pilot Results contained a variety of observations, which the Commission considered in determining whether or not to propose removal of then-current short sale price test restrictions and subsequently whether or not to eliminate such restrictions. Generally, the Pilot Results supported removal of short sale price test restrictions at that time.[43] In addition to the Pilot Results, thirteen other analyses by SEC staff and various third party

NASD to apply its own short sale rule, known as the ''bid test,'' on a pilot basis that was renewed annually until the Commission repealed short sale price tests. NASD's bid test prohibited short sales in Nasdaq Global Market securities (then known as Nasdaq National Market securities) at or below the current (inside) bid when the current best (inside) bid was below the previous best (inside) bid in a security. As a result, until the Commission eliminated former Rule 10a–1, and prohibited any self-regulatory organization (''SRO'') from having a short sale price test in July 2007, Nasdaq Global Market securities traded on Nasdaq or the OTC market and reported to a NASD facility were subject to a bid test. Other listed securities traded on an exchange, or otherwise, were subject to former Rule 10a–1. Nasdaq securities traded on exchanges other than Nasdaq were not subject to any price test. In addition, many thinly-traded securities, such as Nasdaq Capital Market securities, and securities quoted on the over-the-counter (''OTC'') Bulletin Board and Pink Sheets, were not subject to any price test wherever traded. According to the Commission's Office of Economic Analysis (''OEA''), in 2005, prior to the start of the Pilot, NASD Rule 3350 applied to approximately 2,800 securities, while former Rule 10a–1 applied to approximately 4,000 securities.

[28] 17 CFR 242.202T.

[29] *See* 17 CFR 242.202T; *see also* 2004 Regulation SHO Adopting Release, 69 FR at 48012–48013.

[30] *See* Pilot Release, 69 FR 48032 (commencing the Pilot on January 3, 2005 and terminating the Pilot on December 31, 2005). On November 29, 2004, the Commission issued an order resetting the Pilot to commence on May 2, 2005 and end on April 28, 2006 to give market participants additional time to make systems changes necessary to comply with the Pilot. *See* Securities Exchange Act Release No. 50747 (Nov. 29, 2004), 69 FR 70480 (Dec. 6, 2004). On April 20, 2006, the Commission issued an order extending the termination date of the Pilot to August 6, 2007. *See* Securities Exchange Act Release No. 53684 (April 20, 2006), 71 FR 24765 (April 26, 2006).

[31] *See* Pilot Release, 69 FR at 48032. In the 2004 Regulation SHO Adopting Release we noted that ''the purpose of the [P]ilot is to assist the Commission in considering alternatives, such as: (1) Eliminating a Commission-mandated price test for an appropriate group of securities, which may be all securities; (2) adopting a uniform bid test, and any exceptions, with the possibility of extending a uniform bid test to securities for which there is currently no price test; or (3) leaving in place the current price tests.'' 2004 Regulation SHO Adopting Release, 69 FR at 48010.

[32] *See supra* note 6.

[33] OEA selected the securities to be included in the Pilot by sorting the 2004 Russell 3000, first by listing market and then by average daily dollar volume from June 2003 through May 2004, and then within each listing market, selecting every third company starting with the second. Because the selection process relied on average daily dollar volume, companies that had their Initial Public Offering (''IPO'') in May or June 2004, just prior to the Russell reconstitution, were not included. The securities in the control group came from the remainder of the 2004 Russell 3000 not included in the Pilot (excluding the IPOs in May or June 2004 and any securities added to the Russell 3000 after June 2004). *See* OEA Staff's Summary Pilot Report at 22 (discussing the selection of securities included in the Pilot and the control group).

[34] In the 2004 Regulation SHO Adopting Release, the Commission stated its expectation that data on trading during the Pilot would be made available to the public to encourage independent researchers to study the Pilot. *See* 2004 Regulation SHO Adopting Release, 69 FR at 48009, n.9. Accordingly, nine SROs began publicly releasing transactional short selling data on January 3, 2005. The nine SROs at that time were the Amex, ARCA, BSE, CHX, NASD, Nasdaq, National Stock Exchange, NYSE and Phlx. The SROs agreed to collect and make publicly available trading data on each executed short sale involving equity securities reported by the SRO to a securities information processor. The SROs published the information on a monthly basis on their Internet Web sites.

[35] *See* OEA Staff's Summary Pilot Report, at 55 n. 61–63 and supporting text.

[36] On the day the Pilot went into effect, listed Pilot securities underperformed listed control group securities by approximately 24 basis points. The Pilot and control group securities, however, had similar returns over the first six months of the Pilot. *See* OEA Staff's Summary Pilot Report at 8.

[37] *See* OEA Staff's Summary Pilot Report, at 55 n. 61–63 and supporting text.

[38] This conclusion is based on the result that changes in effective spreads were not economically significant (less than a basis point) and that the changes in the bid and ask depth appear not to affect the transaction costs paid by investors. Arguably, the changes in bid and ask depth appeared to affect the intraday volatility. However, OEA concluded that overall, the Pilot data did not suggest a deleterious impact on market quality or liquidity. *See* OEA Staff's Summary Pilot Report at 42, 56.

[39] *See* OEA Staff's Summary Pilot Report at 35.

[40] *See id.*

[41] *See* Karl B. Diether, Kuan Hui Lee and Ingrid M. Werner, 2009, *It's SHO Time! Short-Sale Price-Tests and Market Quality,* Journal of Finance 64:37–73; Gordon J. Alexander and Mark A. Peterson, 2008, *The Effect of Price Tests on Trader Behavior and Market Quality: An Analysis of Reg. SHO,* Journal of Financial Markets 11:84–111; J. Julie Wu, *Uptick Rule, short selling and price efficiency,* August 14, 2006; Lynn Bai, 2008, *The Uptick Rule of Short Sale Regulation—Can it Alleviate Downward Price Pressure from Negative Earnings Shocks?* Rutgers Business Law Journal 5:1–63 (''Bai'').

[42] *See supra* note 5.

[43] *See* 2006 Price Test Elimination Proposing Release, 71 FR at 75072–75075 (discussing the Pilot Results).

researchers were conducted between 1963 and 2004 addressing price test restrictions.[44] Among these were several studies that evaluated short sale price tests during times of severe market decline, including the market break of May 28, 1962, the market decline in September and October 1976, the market break of October 19, 1987, and the Nasdaq market decline of 2000–2001. The results of these studies were mixed, but generally they found that former Rule 10a–1 did not prevent short sales in extreme down markets and did limit short selling in up markets and provided additional support for the removal of short sale price restrictions.

In December 2006, the Commission proposed to eliminate former Rule 10a–1 by removing restrictions on the execution prices of short sales, as well as prohibiting any SRO from having a price test.[45] The Commission received 27 comment letters in response to its proposal to eliminate former Rule 10a–1 and prohibit any SRO from having a short sale price test. The comments in response to the proposed amendments varied. Most commenters (including individual traders, academics, broker-dealers, SROs and trade associations) advocated removing all price test restrictions.[46] Generally, these commenters believed that price test restrictions were no longer necessary due to increased market transparency and the existence of real-time regulatory surveillance that could monitor for and detect any potential short sale manipulation.[47]

Two commenters (both individual investors) opposed the proposed amendments noting the need for price tests to prevent ''bear raids.'' [48] One commenter, although generally in support of removing all price test restrictions, stated the belief that at some level unrestricted short selling should be collared.[49] This commenter supported having a 10% circuit breaker to prevent panic in the event there is a major market collapse.[50] The NYSE also noted its concern about unrestricted short selling during periods of unusually rapid and large market declines. The NYSE stated that the effects of an unusually rapid and large market decline could not be measured or analyzed during the Pilot because such decline did not occur during the period studied.[51]

Effective July 3, 2007, the Commission eliminated former Rule 10a–1 and added Rule 201 of Regulation SHO prohibiting any SRO from having a short sale price test.[52] The Commission stated that it determined to eliminate all short sale price test restrictions after reviewing the comments received in response to its proposal to eliminate all short sale price test restrictions, the Pilot Results, and taking into account the market developments that had occurred in the securities industry since the Commission adopted former Rule 10a–1 in 1938.[53] In addition, the Commission stated that it believed that the amendments would bring increased uniformity to short sale regulation, level the playing field for market participants, and remove an opportunity for regulatory arbitrage.[54]

C. Changes in Market Conditions Since Elimination of Rule 10a–1

Recently, market volatility has increased markedly in the U.S., as well as in every major stock market around the world. Although we are not aware of specific empirical evidence that the elimination of short sale price tests has contributed to the increased volatility in U.S. markets, many members of the public currently associate the removal of former Rule 10a–1 with the recent volatility, including steep declines in some securities' prices, and the loss of investor confidence in our markets.

In addition, we have received numerous requests for reinstatement of short sale price test restrictions from a variety of individuals, including investors, issuers, academics, trade associations, and members of Congress.[55] Most of these commenters have asked that we reinstate short sale price test restrictions because they believe that such a measure would help restore investor confidence.[56]

[44] *See* OEA Staff's Summary Pilot Report at 14, 17–22 (discussing the thirteen studies).

[45] *See* 2006 Price Test Elimination Proposing Release, 71 FR 75068.

[46] *See, e.g.,* letter from Howard Teitelman, CSO, Trillium Trading (Feb. 6, 2007) (''Teitelman Letter''); letter from S. Kevin An, Deputy General Counsel, E*TRADE (Feb. 9, 2007) (''E*TRADE Letter''); letter from Carl Giannone (Feb. 11, 2007) (''Giannone Letter''); letter from David Schwarz (Feb. 12, 2007) (''Schwarz Letter''); letter from John G. Gaine, President, MFA (Feb. 12, 2007) (''MFA Letter''); letter from Lisa M. Utasi, Chairman of the Board and John C. Giesea, President and CEO, STA (Feb. 12, 2007) (''STA Letter''); letter from Gerard S. Citera, Executive Director, U.S. Equities, UBS (Feb. 14, 2007) (''UBS Letter''); letter from Mary Yeager, Assistant Secretary, NYSE (Feb. 14, 2007) (''NYSE Letter''); letter from James J. Angel, Ph.D., CFA, Associate Professor of Finance, McDonough School of Business, Georgetown University (Feb. 14, 2007) (''Angel Letter''); letter from Ira D. Hammerman, SIFMA Managing Director and General Counsel (Feb. 16, 2007) (''SIFMA Letter''); *see also* Securities Exchange Act Release No. 55970 (June 28, 2007), 72 FR 36348, 36350–36351 (July 3, 2007) (''2007 Price Test Adopting Release'') (discussing the comment letters).

[47] *See, e.g.,* Giannone Letter; E*TRADE Letter; STA Letter; UBS Letter; *see also* Securities Exchange Act Release No. 55970 (June 28, 2007), 72 FR 36348, 36350–36351 (July 3, 2007) (discussing the comment letters).

[48] *See, e.g.,* letter from Jim Ferguson (Dec. 19, 2006); letters from David Patch (Jan. 1, 2007; Jan. 12, 2007) (''Patch Letters'').

[49] *See* Giannone Letter.

[50] *See id.*

[51] *See* NYSE Letter.

[52] *See* 2007 Price Test Adopting Release, 72 FR 36348.

[53] *See id* at 36352.

[54] *See id.*

[55] *See, e.g.,* letter to Mary Schapiro, Chairman, from Rep. Barney Frank and other Members of the House Financial Services Committee, dated March 11, 2009; letter to Mary Schapiro, Chairman, Commission, from Professor Constantine Katsoris (''Katsoris letter''), Fordham University School of Law, dated March 4, 2009; letter from Albert C. Roelse, dated Feb. 20, 2009; letter from Robert A. Lee, dated Feb. 10, 2009; letter from Giulio Liotine, dated Jan. 22, 2009 (''Liotine Letter''); letter from Edward L. Yingling, American Bankers Association, dated Dec. 16, 2008 (''American Bankers Assn. 2008 Letter''); letter from Peter Brown, dated Dec. 12, 2008 (''Brown Letter''); letter to Christopher Cox, Chairman, Commission, from Peter T. King, Member of Congress, dated Oct. 7, 2008; letter to Christopher Cox, Chairman, Commission, from Bill Sali, Member of Congress, dated Oct. 1, 2008; letter to Christopher Cox, Chairman, Commission, from T.J. Rodgers, President and CEO, Cypress Semiconductor Corp., dated October 1, 2008; letter to Christopher Cox, Chairman, Commission, from Carl H. Tiedmann, General Partner, Tiedmann Investment Group, dated Sept. 22, 2008; letter to Christopher Cox, Chairman, Commission, from Hillary Rodham Clinton, Senator, dated Sept. 17, 2008 (''Clinton Letter''). The Commission's Office of Investor Education and Advocacy estimates that it has received over 4,000 requests (including duplicate requests) from individuals regarding reinstating a short sale price test.

[56] *See, e.g.,* letter from Chris Baratta, dated March 9, 2009 (''Baratta Letter''); letter from Paul Kent, dated March 7, 2009; letter from Troy Williams, dated March 6, 2009; letter from Briggs Diuguid, dated March 5, 2009 (''Diuguid Letter''); letter from Bob Young, dated March 5, 2009; letter from Kevin Girard, dated March 4, 2009; letter from Mike Rogers, dated March 3, 2009; letter from George Flagg, dated March 3, 2009; letter from Arleen Golden, dated March 2, 2009; letter from Doug Cameron, dated March 2, 2009; letter from Dr. Bill Daniel, dated Feb. 26, 2009; letter from Glenn Webster, dated Feb. 26, 2009; letter from Robert Lounsbury, dated Feb. 25, 2009; letter from Karl Findorff, dated Feb. 19, 2009; letter from Robert Levine, dated Feb. 17, 2009; letter from Robert Lee, dated Feb. 10, 2009; American Bankers Assn. 2008 letter; letter from David Campbell and Natalie Win, dated Nov. 25, 2008; letter from Josh Dodson, dated Nov. 21, 2008; letter from J. Geddes Parsons, dated Nov. 21, 2008; letter from Charles Rudisill, dated Nov. 21, 2008; letter from Mike Ryan, dated Nov. 21, 2008; letter from Jeff Brower, dated Nov. 20, 2008; letter from Mike Abraham, dated Nov. 20, 2008; letter from Marvin Dingott, dated Nov. 20, 2008; letter from W. Romain Spell, dated Nov. 19, 2008; letter from Phil Mason, dated Nov. 19, 2008; letter from David Sheridan, dated Nov. 18, 2008; letter from Lynn Miller, dated Nov. 13, 2008; letter from Patrick McQuaid, dated Oct. 29, 2008; letter from Scotland Settle, dated Oct. 27, 2008; letter from Jenna Spurrier, dated Oct. 24, 2008; letter from Joe Garrett, dated Oct. 15, 2008; letter from Peter Eckle, dated Oct. 11, 2008; letter from Maureen Christensen, dated Oct. 9, 2008; letter from Richard Vulpi, dated Sept. 24, 2008; *see also* Katsoris Letter (stating that elimination of former Rule 10a–1 ''* * * hardly generates confidence on the part of a true investor who is entrusting his or her life's savings * * * to the current market'').

Some of these commenters have stated that a lack of price test restrictions makes them question whether they should invest in the stock market.[57] Other commenters have stated that they believe a short sale price test would aid small investors.[58] In addition, some commenters have asserted that restricting the prices at which securities may be sold short would help address recent steep declines in securities' prices. For example, the American Bankers Association (the ''ABA'') noted that its members, ''both large and small, are telling [the ABA] that short sellers are taking advantage of the uptick rule's absence and that their stock prices are experiencing excessive downward price pressure * * *.'' [59] This commenter further noted that ''its members strongly believe that reinstatement of the uptick rule in some format would help limit these downward stock spirals and restore investor confidence.'' [60]

In commenting on the recent market volatility and the absence of a short sale price test, one member of Congress recently stated that ''[o]ne of the simplest but most important and effective initiatives that the SEC could undertake immediately to combat market volatility is the reinstatement of a * * * 'uptick rule'.'' [61] A former U.S. Senator urged the Commission to ''* * * give close consideration to the many calls for the immediate restoration of the uptick rule whose repeal has been linked to the recent market volatility and proliferation of abusive short sale transactions.'' [62] SRO representatives and others have also commented on the need for a short sale price test.[63] Researchers have also indicated that they believe that they have collected data that establishes a possible association between the current market downturn and the elimination of former Rule 10a–1.[64] In addition, we note that recently there are reports of significant short selling in connection with credit default swaps, particularly in the securities of significant financial institutions.[65] One commenter has suggested that the interaction between and amplifying effects of credit default swaps and short selling may be a reason to reinstate a short sale price test.[66]

Questions and comments have been raised about the role that short selling, and in particular potentially abusive short selling, may have in connection with the price fluctuations and disruption in our markets. As such, recently we took a number of short sale-related actions aimed at addressing these concerns. For example, due to our concerns that false rumors spread by short sellers regarding financial institutions of significance in the U.S. may have fueled market volatility in the securities of some of these institutions, on July 15, 2008, we issued an emergency order (''July Emergency Order'') [67] pursuant to Section 12(k)(2) of the Exchange Act [68] which imposed borrowing and delivery requirements on short sales of the equity securities of certain financial institutions. We noted in the July Emergency Order that false rumors can lead to a loss of confidence in our markets. Such loss of confidence can lead to panic selling, which may be further exacerbated by ''naked'' short selling. As a result, the prices of securities may artificially and unnecessarily decline well below the price level that would have resulted from the normal price discovery process.[69] If significant financial institutions are involved, this chain of events can threaten disruption of our markets.[70]

Due to our concerns regarding the impact of short selling on the prices of financial institution securities, on September 18, 2008, we issued another emergency order prohibiting short selling in the publicly traded securities of certain financial institutions.[71] Our concerns, however, have not been limited to financial institutions given the importance of confidence in our markets and recent rapid and steep declines in the prices of securities generally.[72] Such rapid and steep price declines can give rise to questions about the underlying financial condition of an institution, which in turn can erode confidence even without an underlying fundamental basis.[73] This erosion of confidence can impair the liquidity and ultimate viability of an institution, with potentially broad market consequences.[74]

These concerns resulted in our issuance on September 17, 2008 of an emergency order under Section 12(k)(2) of the Exchange Act, in part targeting

[57] *See, e.g.,* letter from Tim Zanni, dated Feb. 19, 2009; letter from Jeff Boyd, dated Feb. 10, 2009.

[58] *See, e.g.,* Baratta Letter (noting that while price test restrictions could not reasonably be expected to prevent market downturns, they would, in his opinion, ''give the little investor a chance'' in the current conditions). *See also* Young Letter (suggesting that reinstatement of the uptick rule ''will not be a quick or total fix, but it will help''); letter to Mary Schapiro, Chairman, Commission, from Paul D. Mendelsohn, President of Windham Financial Services, Inc., dated March 6, 2009 (stating that he believes former Rule 10a–1 ''protected'' the markets and that ''suspension of the uptick rule has opened a security hole into our financial system'').

[59] *See* American Bankers Assn. 2009 Letter.

[60] *See id.* See also letter to Christopher Cox, Chairman, Commission, from Paul Tudor Jones II, Tudor Investment Corporation, dated Oct. 10, 2008 (stating that he believes that one way to ''immediately stem the decline'' in the stock market would be to reinstate the uptick rule); letter to Mary Schapiro, Chairman, Commission, from James F. Kane, Jr., dated Feb. 6, 2009 (stating that he believes that reinstating ''the Up-tick Rule will go a long way in preventing speculators from ganging up on a particular stock and forcing it down''); Diuguid Letter (stating that while short sellers ''make efficient markets,'' he is nonetheless concerned that short selling may be a tool of manipulators when short sales are ''piled on'' a particular company).

[61] *See* letter to Mary Schapiro, Chairman, Commission, from Gary L. Ackerman, Member of Congress, dated Jan. 27, 2009.

[62] *See* Clinton Letter.

[63] *See, e.g.,* Edgar Ortega, *Short-Sale Rule Undermined as Bernanke Backs Review,* Bloomberg News Service, March 4, 2009 (noting comments by Duncan Niederauer, CEO, The NYSE/Euronext Group, Inc., that imposing a measure such as former Rule 10a–1 ''would go a long way to adding confidence'' in our markets); Ben Stein, *How to Deal with a 3 A.M. Fear,* The New York Times, March 8, 2009; Charles R. Schwab, *Restore the Uptick Rule, Restore Confidence,* Wall Street Journal Online, December 9, 2008. The Federal Reserve Chairman also recently noted that, while the ''traditional literature on this doesn't seem to find much effect of the uptick rule,'' short sale price test restrictions are ''worth looking at'' and that the rule (*i.e.,* former Rule 10a–1) ''might have had some benefit.'' *Monetary Policy and the State of the Economy: Hearing Before the House Financial Services Comm., 111th Cong., 1st Sess.* (Lexis Federal News Service at 33) (Feb. 25, 2009). *See also* letter from Duncan Niederauer, CEO, The NYSE/Euronext Group, Inc., Robert Greifeld, CEO, The NASDAQ OMX Group, Inc., Joe Ratterman, CEO, BATS Exchange, Inc., Joseph Rizzello, CEO, National Stock Exchange, dated March 24, 2009 (''National Exchanges Letter'') (stating that the United States national securities exchanges welcome the announcement that the Commission will consider a proposal to adopt a rule to combat abusive short selling and suggesting that any such rule proposal include a circuit breaker in the form discussed therein).

[64] *See* D. Harmon and Y. Bar-Yam, 2008, *Technical Report on the SEC Uptick Repeal Pilot,* New England Complex Systems Institute; *see also* Robert C. Pozen and Dr. Yaneer Bar-Yam, *There's a Better Way to Prevent Bear Raids,* The Wall Street Journal, Opinion, November 18, 2008 (stating that the ''uptick rule'' is an effective way to prevent ''bear raids''). *But cf.* John C. Bogle, Jr. and Howard Flinker, *Uptick Rule Won't Prevent More Raids by the Bear,* The Wall Street Journal, Opinion Section (November 26, 2008).

[65] *See* George Soros, *The Game Changer,* available at *http://www.ft.com/cms/s/0/49b1654a-ed60-11dd-bd60-0000779fd2ac.html.*

[66] *See id.* (concluding that Lehman, AIG and other financial institutions were destroyed by ''bear raids'' in which the shorting of stocks and buying of CDS amplified and reinforced each other).

[67] *See* Securities Exchange Act Release No. 58166 (July 15, 2008), 73 FR 42379 (July 21, 2008).

[68] 15 U.S.C. 78*l*(k).

[69] *See* July Emergency Order, 73 FR 42379.

[70] *See id.*

[71] *See* Securities Exchange Act Release No. 58592 (Sept. 18, 2008), 73 FR 55169 (Sept. 24, 2008).

[72] *See, e.g.,* July Emergency Order, 73 FR 42379; Securities Exchange Act Release No. 58592 (Sept. 18, 2008), 73 FR 55169 (Sept. 24, 2008) (''Short Sale Ban Emergency Order''); Securities Exchange Act Release No. 58572 (Sept. 17, 2008), 73 FR 54875 (Sept. 23, 2008) (''September Emergency Order'').

[73] *See* Short Sale Ban Emergency Order, 73 FR 55169; September Emergency Order, 73 FR 54875.

[74] *See id.*

short selling in all equity securities.[75] Pursuant to the September Emergency Order we imposed enhanced delivery requirements on sales of all equity securities under Rule 204T of Regulation SHO.[76]

The enhanced close-out requirements of Rule 204T of Regulation SHO in the September Emergency Order, which, among other things, require participants of a registered clearing agency to close-out fails to deliver resulting from short sales of any equity security by purchasing or borrowing the security by no later than the beginning of trading on the day after the fail to deliver occurs, appear to be having a positive effect toward achieving our goal of reducing fails to deliver.[77] As we stated in the October 2008 release adopting Rule 204T as an interim final temporary rule, we are concerned about the potentially negative market impact of large and persistent fails to deliver.[78] Thus, our adoption of Rule 204T followed a series of other steps aimed at reducing such fails to deliver and addressing potentially abusive short selling. Such steps included eliminating the ''grandfather'' and options market maker exceptions to Regulation SHO's close-out requirement,[79] and proposing and subsequently adopting a ''naked'' short selling anti-fraud rule, Rule 10b–21.[80] Although we recognize that fails to deliver can occur for legitimate reasons, we are concerned about the impact of large and persistent fails to deliver on market confidence. Preliminary results from OEA indicate that our actions to further reduce fails to deliver and, thereby, address potentially abusive short selling are having their intended effect. For example, preliminary results from OEA indicate that fails to deliver in all equity securities have declined significantly since the adoption of Rule 204T.[81]

Questions persist, however, about the rapid and steep declines in the prices of securities, and we recognize the concern over the continuing erosion of investor confidence in our markets. Thus, we have continued to examine whether there are other actions that the Commission might consider, including re-evaluating whether a short sale price test ought to be reintroduced or a circuit breaker rule should be imposed, in light of the extreme market declines and volatility, as well as the loss of investor confidence we continue to experience.

We also note that when we eliminated all short sale price test restrictions in July 2007, we acknowledged that circumstances may develop that would warrant relief from the prohibition in Rule 201 of Regulation SHO for a short sale price test, including a short sale price test of an SRO, to apply to short sales in any security.[82] Thus, in determining whether or not to propose a short sale price test rule or circuit breaker rule, we have considered the recent turmoil in the financial sector and steep declines and extreme volatility in securities prices. The turbulence in the financial markets has been underscored over the past 18 months by events such as the March 2008 sale of Bear Stearns Corporation, and the crisis surrounding the collapse of Lehman Brothers in September 2008.

In addition, between July 2007 and March 2009, the Dow Jones Industrial Average (''DJIA'') lost roughly 50% of its value, while the Standard and Poor's 500 Index fell approximately 54%.[83] The publicly traded securities of significant financial institutions have experienced large reductions in value in 2008 and early 2009.[84] For example, one significant financial institution's stock price declined from approximately $49 per share in the beginning of July 2007, to approximately $1 per share in March 2009. Similarly, in July 2007, another significant financial institution's stock price declined from approximately $49 per share to approximately $3 per share in March 2009. In addition, in 2008, a number of major banks became the subjects of federal seizure.[85] A total of 25 banks failed in 2008, resulting in a $33.5 billion expenditure of the fund used by the Federal Deposit Insurance Corporation (''FDIC'') to protect individual depositors' savings.[86] Put simply, market conditions have changed dramatically in recent months.[87]

In addition, as noted above, in response to the proposed amendments to eliminate former Rule 10a–1, one commenter expressed its concern about unrestricted short selling during periods of unusually rapid and large market declines.[88] This concern has been echoed in recent comment letters to the Commission.[89] We note, however, that in the 2007 Price Test Adopting Release, we noted that because of the Commission's stated objective when it adopted Rule 10a–1 and our concerns about the potential use of short sales to manipulate stock prices, OEA examined the Pilot data for any indication that there is an association between extreme price movements and price test

[75] *See* September Emergency Order, 73 FR 54875.

[76] *See id.* We subsequently issued an interim final temporary rule imposing the delivery requirements of Rule 204T of Regulation SHO until July 31, 2009. *See* Securities Exchange Act Release No. 58773 (Oct. 14, 2008), 73 FR 61706 (Oct. 17, 2008) (''Interim Final Temporary Rule 204T''). We and Commission staff are currently reviewing the comment letters received in response to that rule. In addition, we issued an emergency order, and subsequent interim final temporary rule, to require disclosure of short sales and short positions in certain securities. The temporary rule expires on August 1, 2009. We and Commission staff are currently reviewing comment letters received in response to the temporary rule. *See* Securities Exchange Act Release No. 58591 (Sept. 18, 2008). *See also* Securities Exchange Act Release No. 58785 (Oct. 15, 2008), 73 FR 61678 (Oct. 17, 2008).

[77] *See* September Emergency Order, 73 FR 54875.

[78] *See* Interim Final Temporary Rule 204T, 73 FR at 61708.

[79] *See* Securities Exchange Act Release No. 56212 (Aug. 7, 2007), 72 FR 45544 (Aug. 14, 2007) (eliminating the ''grandfather'' exception to Regulation SHO's close-out requirement); September Emergency Order, 73 FR 54875 (eliminating the options market maker exception to Regulation SHO's close-out requirement). Following the issuance of the September Emergency Order, we adopted amendments making permanent the elimination of the options market maker exception. *See* Securities Exchange Act Release No. 58775 (Oct. 14, 2008), 73 FR 61690 (Oct. 17, 2008).

[80] *See* Securities Exchange Act Release No. 58774 (Oct. 14, 2008), 73 FR 61666 (Oct. 17, 2008); Securities Exchange Act Release No. 57511 (March 17, 2008), 73 FR 15376 (March 21, 2008).

[81] *See* Memorandum from OEA Re: Impact of Recent SHO Rule Changes on Fails to Deliver, November 26, 2008 at *http://www.sec.gov/comments/s7-30-08/s73008-37.pdf;* Memorandum from OEA Re: Impact of Recent SHO Rule Changes on Fails to Deliver, March 20, 2009 at *http://www.sec.gov/comments/s7-30-08/s73008-107.pdf* (stating, among other things, that the average daily number of aggregate fails to deliver for all securities decreased from 1.1 billion to 582 million for a total decline of 47.2% when comparing a pre-Rule to post-Rule period).

[82] *See* 2007 Price Test Adopting Release, 72 FR 36348.

[83] On July 3, 2007, the DJIA closed at 13,577, and on March 3, 2009, the DJIA closed at 6,726. On July 3, 2007, the S&P 500 Index closed at 1524.87, and on March 3, 2009, the S&P 500 Index closed at 700.82.

[84] We note that we have no empirical evidence that such falling prices are the result of short selling activity and the lack of short sale price test restrictions.

[85] *See, e.g.,* Office of Thrift Supervision, *Receivership Of A Federal Saving Association,* dated Sept. 25, 2008 at *http://files.ots.treas.gov/680024.pdf;* Office of Thrift Supervision, *Pass-Through Receivership Of A Federal Savings Association Into A De Novo Federal Savings Association That Is Placed Into Conservatorship With the FDIC,* dated July 11, 2008 at *http://files.ots.treas.gov/680018.pdf.*

[86] *See* Alison Vekshin, *Bair Says Insurance Fund Could Be Insolvent This Year, http://www.bloomberg.com/apps/news?pid=washingtonstory&sid=alsJZqIFuN3k,* March 4, 2009.

[87] We note, however, that stock markets have incurred significant declines in value under former short sale price test restrictions, most notably the 1987 Market Crash and the 2000 Tech Bubble Burst.

[88] *See* NYSE letter.

[89] *See, e.g.,* Brown Letter (noting that ''the investigation performed before the uptick rule was rescinded was insufficient, particularly [because] it covered a period of relative market stability and studied the side effects of the rule rather than the primary effect of the rule which would only be seen in a sharply down market such as we have just suffered''); Liotine Letter (stating that ''[t]he research done prior to the [amendment] of rule 10–A was far too short'' and that the study should have lasted longer to ''ensure at least one bear market was involved in the study'').

restrictions. OEA, however, did not find any such association.[90]

Due to the extreme market conditions with which we are currently faced and the resulting deterioration in investor confidence, we believe it is appropriate at this time to propose amending Regulation SHO to add a short sale price test or a circuit breaker rule. In issuing this proposing release, we seek empirical data regarding the costs and benefits of reinstating short sale price test restrictions or imposing circuit breaker rules, including the potential impact on legitimate short selling. We note that although we have received numerous letters requesting reinstatement of short sale price test restrictions, such requests have not included empirical data, but rather focus on what such commenters believe might be the impact on the markets of reinstating such restrictions. In addition, such requests do not discuss the potential impact of short sale price test restrictions on the benefits of legitimate short selling.

As discussed in this release, we remain mindful that there are benefits of short selling. For example, legitimate short selling can play an important and constructive functional role in the markets, providing liquidity and price efficiency. Short sellers also play an important role in correcting upward stock price manipulation.[91] Because short sale price test restrictions may lessen some of these benefits, it is important that any short sale price test regulation be designed to limit any potentially unnecessary impact on legitimate short selling.

We also recognize that some market participants may be advocating for a short sale price test because such participants may believe that it would put them at a competitive advantage over other participants who may be less able to implement or adjust their trading strategies to account for a short sale price test or may otherwise benefit at the expense of investors. Other market participants may favor a short sale price test due to concerns about the imposition of a greater restriction on short selling.

We believe that all arguments, both for and against a short sale price test rule and a possible circuit breaker rule, should be considered and addressed in light of current market conditions and recent experience. Thus, we believe it is important at this time to propose and obtain informed public comment regarding restricting the prices at which securities can be sold short before determining whether or not to impose any such restrictions, and what any such restrictions should be, as well as the proposed circuit breaker rules.

As discussed in detail below, we are proposing two alternative price tests. The first test would be the proposed modified uptick rule that would be based on the national best bid. The second test would be the proposed uptick rule that would be a modified version of the tick test under former Rule 10a–1. We are also proposing amendments to Rule 200(g) of Regulation SHO that would require that a broker-dealer mark certain sell orders ''short exempt.''

In considering whether to reinstitute short sale price test restrictions, it is important that the Commission take into account any extant empirical data and analyses that would shed light on the potential impact of such restrictions on capital markets. In that connection, we note that OEA has analyzed the impact that a short sale price test might have had during a thirteen day period in September of 2008 [92] as well as whether and the extent to which short selling drove prices downward during a volatile period in early September 2008.[93] The first of these studies noted that, although its data were limited to historical trade and quote data from a period when no price test was in place and the shape of order book and trading sequences might have differed had a price test been in place, a price test would likely have been most restrictive during periods of low volatility, with greatest impact on short selling in lower priced and more active stocks.[94] The second study found that long sellers were primarily responsible for price declines during this period. It also found that, on average, short sale volume as a fraction of total volume was highest during periods of positive returns, noting, however, that it was also possible that there were instances in which short selling activity peaked during periods of extreme negative returns.[95] The Commission looks forward to receiving additional analysis of relevant data and factors.

Similarly, it is important that the Commission take into account any extant empirical data and analyses that would shed light on the potential impact of such restrictions on capital markets, and it looks forward to receiving analysis of relevant data.

III. Discussion of Proposed Short Sale Restrictions

We discuss below our price test approach, the alternatives contained therein and our circuit breaker approach. As noted above, we preliminarily believe that a price test based on the national best bid would have advantages over a test based on the last sale price in today's markets. In particular, we believe that bids generally are a more accurate reflection of current prices for a security than last sale prices due to delays that can occur in the reporting of last sale price information and because last sale price information is published to the markets in reporting rather than trade sequence.

In adopting a final rule, we could take several different approaches, or a combination of approaches. For example, we could consider a straight prohibition approach prohibiting all persons from effecting short sales under a price test that references either the national best bid or the last sale price; a policies and procedures approach imposing obligations on market participants to adopt policies and procedures to guard against impermissible short selling; or a combination of a straight prohibition and a policies and procedures approach.

We discuss below the proposed modified uptick rule which would require trading centers to have policies and procedures reasonably designed to prevent the execution or display of short sales at impermissible prices. As an alternative, in Section II.B, below, we discuss the proposed uptick rule that is based on the last sale price and that, similar to former Rule 10a–1, would apply a straight prohibition approach that would prohibit any person from effecting short sales at impermissible prices. However, either alternative could ultimately be implemented through a policies and procedures or through a straight prohibition approach or some combination thereof.

We also discuss below our circuit breaker approach, which includes two basic alternatives—a halt and a price test. The proposed circuit breaker price test rule would temporarily result in either the proposed modified uptick rule or the proposed uptick rule applying to a specific security if there was a severe decline in the price of that security. As with the proposed short sale price test rules, the proposed circuit breaker price test rules could also be in the form of either a straight prohibition

[90] *See* 2007 Price Test Adopting Release, 72 FR at 36351.

[91] *See* OEA Staff's Summary Pilot Report, at 9.

[92] *See* Office of Economic Analysis, *Analysis of a short sale price test using intraday quote and trade data,* Dec. 17, 2008.

[93] *See* Office of Economic Analysis, *Analysis of Short Selling Activity during the First Weeks of September, 2008,* Dec. 16, 2008.

[94] *See* OEA analysis (Dec. 17, 2008), *supra* note 92.

[95] *See* OEA analysis (Dec. 16, 2008), *supra* note 93.

or a policies and procedures approach. The proposed circuit breaker halt rule, which would temporarily halt short selling in a specific security if there is a severe price decline in that security, could operate either in addition to, or in place of, a proposed short sale price test rule.

A. Proposed Modified Uptick Rule

1. Operation of the Proposed Modified Uptick Rule

We are proposing to amend Rule 201 of Regulation SHO to add a short sale price test that would use the national best bid as a reference point for short sale orders. Specifically, the proposed modified uptick rule would provide that ''[a] trading center shall establish, maintain, and enforce written policies and procedures reasonably designed to prevent the execution or display of a short sale order in a covered security at a down-bid price.'' [96] The proposed modified uptick rule defines a ''down-bid price'' as ''a price that is less than the current national best bid or, if the last differently priced national best bid was greater than the current national best bid, a price that is less than or equal to the current national best bid.'' [97]

Thus, under the proposed modified uptick rule, a trading center would be required to have policies and procedures reasonably designed to prevent it from executing or displaying any short sale order, absent an exception, at a price that is below the national best bid. If the current national best bid is below the last differently priced national best bid, a trading center would be required to have policies and procedures reasonably designed to prevent it from executing or displaying the order unless the order is priced above the current national best bid. Such a rule might help prevent short sellers from driving the market down. In addition, the proposed modified uptick rule might help prevent short sales from being used as a tool to accelerate a declining market.

The following example demonstrates the operation of the proposed modified uptick rule. If the current national best bid in a security is $47.00, and the immediately preceding national best bid was $46.99 (*i.e.,* the current bid is above the previous bid), a trading center could immediately execute a short sale order at $47.00 or above. Similarly, a trading center could display a short sale order priced at $47.00 or above.[98] If the current national best bid in a security is $47.00, and the immediately preceding bid was $47.01 (*i.e.,* the current bid is below the previous bid), a trading center could execute or display a short sale order at a price above $47.00.[99] If the current national best bid in a security is $47.00, and the immediately preceding national best bid was $47.00, but that bid was above the prior national best bid (*i.e.,* the last differently priced national best bid), a trading center could execute a short sale order at $47.00 or above. Similarly, a trading center could display a short sale order priced at $47.00 or above.[100] If the current national best bid is $47.00, and the immediately preceding national best bid was $47.00, but that was below the prior national best bid (*i.e.,* the last differently priced national best bid), a trading center could execute or display a short sale at a price above $47.00.[101]

The proposed modified uptick rule would apply to any ''covered security,'' which is defined as an ''NMS stock'' under Rule 600(b)(47) of Regulation NMS.[102] Rule 600(b)(47) of Regulation NMS defines an ''NMS stock'' as ''any NMS security other than an option.'' [103] Rule 600(b)(46) of Regulation NMS defines an ''NMS security'' as ''any security or class of securities for which transaction reports are collected, processed, and made available pursuant to an effective transaction reporting plan, or an effective national market system plan for reporting transactions in listed options.'' [104] Thus, the proposed modified uptick rule would apply to any security or class of securities, except options, for which transaction reports are collected, processed, and made available pursuant to an effective transaction reporting plan.[105] As a result, the proposed modified uptick rule generally would cover all securities, except options, listed on a national securities exchange whether traded on an exchange or in the over-the-counter (''OTC'') market. It would not include non-NMS stocks quoted on the OTC Bulletin Board or elsewhere in the OTC market. We are not proposing to apply the proposed modified uptick rule to non-NMS stocks quoted on the OTC Bulletin Board or elsewhere in the OTC market because a national best bid and offer currently is not required to be collected, consolidated, and disseminated for such securities. In addition, former Rule 10a–1 did not apply to non-exchange listed securities quoted on the OTC Bulletin Board or elsewhere in the OTC market. We recognize, however, that issuers of securities quoted in the OTC market may believe that they are particularly vulnerable to abusive short selling. Thus, we seek specific comment regarding whether the proposed modified uptick rule or some other form of price test, or any other restrictions on short sales, should apply to these types of securities.

The scope of securities covered by the proposed modified uptick rule would be similar to the scope of securities covered by former Rule 10a–1. Former Rule 10a–1(a) applied to securities registered on, or admitted to unlisted trading privileges on, a national securities exchange, if trades of the security were reported pursuant to an effective transaction reporting plan and information regarding such trades was made available in accordance with such plan on a real-time basis to vendors of market transaction information. All securities that would have been subject to former Rule 10a–1 would also be subject to the proposed modified uptick rule. In addition, certain securities, *i.e.,* securities traded on Nasdaq prior to its regulation as an exchange, that were not subject to former Rule 10a–1, would be subject to the proposed modified uptick rule.[106]

Market information for NMS stocks, including quotes, is disseminated pursuant to three different national market system plans.[107] The national

[96] *See* Proposed Rule 201(b)(1).

[97] Proposed Rule 201(a)(2).

[98] A trading center could display a short sale order priced at $47.00 provided such order would comply with the locking or crossing requirements of any Commission or SRO rule. *See, e.g.,* 17 CFR 242.610(d).

[99] Any such execution or display would also need to be in compliance with applicable rules regarding minimum pricing increments. *See* 17 CFR 242.612.

[100] A trading center could display a short sale order priced at $47.00 provided such order would comply with the locking or crossing requirements of any Commission or SRO rule. *See, e.g.,* 17 CFR 242.610(d).

[101] Any such execution or display would also need to be in compliance with applicable rules regarding minimum pricing increments. *See* 17 CFR 242.612.

[102] *See* proposed Rule 201(a)(1).

[103] 17 CFR 242.600(b)(47).

[104] 17 CFR 242.600(b)(46).

[105] *See* proposed Rule 201(a)(1) (providing that a ''covered security'' shall mean all ''NMS stock'' as defined in § 242.600(b)(47) of Regulation NMS).

[106] When Nasdaq became a national securities exchange in 2006, absent an exemption from former Rule 10a–1, all Nasdaq securities would have been subject to former Rule 10a–1. The Commission provided Nasdaq with an exemption from the application of the provisions of former Rule 10a–1 to securities traded on Nasdaq because the Pilot was already in progress, and the Commission believed it was necessary and appropriate to maintain the status quo for short sale price tests during the Pilot, and to ensure that market participants would not be burdened with costs associated with implementing a price test that might be temporary. *See* letter to Marc Menchel, Executive Vice President and General Counsel, NASD, Inc., June 26, 2006.

[107] The three joint-industry plans are (1) the Consolidated Tape Association Plan (''CTA Plan''), which disseminates transaction information for

securities exchanges and FINRA participate in these joint-industry plans (''Plans'').[108] The Plans establish three separate networks to disseminate market information for NMS stocks.[109] These networks are designed to ensure that, among other things, consolidated bids from the various trading centers that trade NMS stocks are continually collected and disseminated on a real-time basis, in a single stream of information. Thus, all trading centers would have access to the consolidated bids for all the securities that would be subject to the proposed modified uptick rule.[110] As discussed in further detail below, however, we note that the national best bid can change rapidly and repeatedly and potentially there might be latencies in obtaining data regarding the national best bid.

The proposed modified uptick rule would apply to any trading center that executes or displays a short sale order in a covered security. It would define a ''trading center'' as ''a national securities exchange or national securities association that operates an SRO trading facility, an alternative trading system, an exchange market maker, an OTC market maker, or any other broker or dealer that executes orders internally by trading as principal or crossing orders as agent.'' [111] The proposed definition encompasses all entities that may execute short sale orders. Thus, the proposed modified uptick rule would apply to any entity that executes short sale orders.

Under the proposed modified uptick rule, a trading center would be required to have written policies and procedures reasonably designed to prevent the execution or display of short sale orders on a down-bid price. Thus, upon receipt of a short sale order, a trading center's policies and procedures would have to require that the trading center be able to determine whether or not the short sale order could be executed or displayed in accordance with the provisions of proposed Rule 201(b)(1). If the order is marketable at a permissible price, the trading center would be able to present the order for immediate execution or, if not immediately marketable, hold for execution later at its specified price.

The proposed modified uptick rule would permit a trading center to display an order provided it is permissibly priced at the time the trading center displays the order. If an order is impermissibly priced, the trading center could, in accordance with policies and procedures reasonably designed to prevent the execution or display of a short sale order at a down-bid price, re-price the order at the lowest permissible price and hold it for later execution at its new price or better.[112] As quoted prices change, the proposed rule would allow a trading center to repeatedly re-price and display an order at the lowest permissible price down to the order's original limit order price (or, if a market order, until the order is filled).

In addition, paragraph (b)(1)(i) of the proposed rule would require a trading center's policies and procedures to be reasonably designed to permit a trading center to execute a displayed short sale order at a down-bid price provided that, at the time the order was displayed by the trading center it was permissibly priced, *i.e.,* not on a down-bid price.[113] This exception for properly displayed short sale orders would help avoid a conflict between the proposed modified uptick rule and the ''Quote Rule'' under Rule 602 of Regulation NMS. The Quote Rule requires that, subject to certain exceptions, the broker-dealer responsible for communicating a quotation shall be obligated to execute any order to buy or sell presented to him, other than an odd lot order, at a price at least as favorable to such buyer or seller as the responsible broker-dealer's published bid or published offer in any amount up to his published quotation size.[114] Thus, pursuant to this exception, a trading center would be able to comply with the ''firm quote'' requirement of Rule 602 of Regulation NMS by executing a presented order to buy against its displayed offer to sell as long as the displayed offer to sell was permissibly priced under the proposed rule at the time it was first displayed, even if the execution of the transaction would be on a down-bid price at the time of execution.

Because a trading center could re-price and display a previously impermissibly priced short sale order the proposed modified uptick rule potentially allows for the more efficient functioning of the markets than the proposed uptick rule because trading centers would not have to reject or cancel impermissibly priced orders unless instructed to do so by the trading center's customer submitting the short sale order. We recognize that some trading centers might not want to re-price an impermissibly priced short sale order. Thus, re-pricing would not be a requirement under the proposed modified uptick rule.

In addition, the proposed modified uptick rule would provide trading centers and their customers with flexibility in determining how to handle orders that are not immediately executable or displayable by the trading center because the order is impermissibly priced. For example, trading centers could offer their customers various order types regarding the handling of impermissibly priced orders such that a trading center either could reject an impermissibly priced order or re-price the order at the lowest permissible price until the order is filled.

The proposed modified uptick rule would focus on a trading center's written policies and procedures as the mechanism through which to prevent the execution or display of short sale orders on a down-bid price. Under this approach, trading centers would be required to have policies and procedures reasonably designed to prevent the execution or display of short sale orders at impermissible prices and to surveil the effectiveness of the policies and procedures. Thus, short sale orders executed or displayed at impermissible prices would require the trading center that executed or displayed the short sales to take prompt action to remedy any deficiencies.

We also note that the policies and procedures requirements of the proposed modified uptick rule are similar to those set forth under

securities primarily listed on an exchange other than Nasdaq, (2) the Consolidated Quotation Plan (''CQ Plan''), which disseminates consolidated quotation information for securities primarily listed on an exchange other than Nasdaq, and (3) the Nasdaq UTP Plan, which disseminates consolidated transaction and quotation information for securities primarily listed on Nasdaq.

[108] Rule 603(b) of Regulation NMS provides that every national securities exchange on which an NMS stock is traded and national securities association shall act jointly pursuant to one or more effective national market system plans to disseminate consolidated information, including a national best bid and national best offer, for NMS stocks. *See* 17 CFR 242.603(b).

[109] These networks can be categorized as follows: (1) Network A—securities primarily listed on the NYSE; (2) Network B—securities listed on exchanges other than the NYSE and Nasdaq; and (3) Network C—securities primarily listed on Nasdaq.

[110] *See* Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496, 37503 (June 29, 2005) (''Regulation NMS Adopting Release'').

[111] *See* 17 CFR 242.600(b)(78); *see also* proposed Rule 201(a)(7) (providing that the term ''trading center'' shall have the same meaning as in § 242.600(b)(78) of Regulation NMS).

[112] For example, if a trading center receives a short sale order priced at $47.00 when the current national best bid in the security is $47.00, but the immediately preceding national best bid was $47.01 (*i.e.,* the current bid is below the previous bid), the trading center could re-price the order at the permissible offer price of $47.01, and display the order for execution at this new limit price.

[113] *See* proposed Rule 201(b)(1)(i).

[114] *See* 17 CFR 242.602(b)(2). We note that to the extent that a short sale order is undisplayed, the proposed modified uptick rule would prevent the trading center from executing the order unless at the time of execution, the execution price complies with the proposed modified uptick rule at the time of execution of the order.

Regulation NMS.[115] In accordance with Regulation NMS, trading centers must have in place written policies and procedures in connection with that Regulation's order protection rule.[116] Thus, trading centers are already familiar with establishing, maintaining, and enforcing trading-related policies and procedures, including programming their trading systems in accordance with such policies and procedures. This familiarity should reduce the implementation costs of the proposed modified uptick rule on trading centers.

Similar to the requirements under Regulation NMS in connection with the order protection rule,[117] at a minimum, a trading center's policies and procedures would need to enable a trading center to monitor, on a real-time basis, the national best bid, and whether the current national best bid is an up- or down-bid from the last differently priced national best bid, so as to determine the price at which the trading center may execute or display a short sale order. In addition, a trading center would need to have policies and procedures reasonably designed to permit the execution or display of a short sale order of a covered security marked ''short exempt'' without regard to whether the order is at a down-bid price.[118] A trading center's policies and procedures would not, however, have to include mechanisms to determine on which provision a broker-dealer is relying in marking an order ''short exempt'' in accordance with paragraph (c) or (d) of the proposed modified uptick rule.[119]

A trading center would also need to take such steps as would be necessary to enable it to enforce its policies and procedures effectively. For example, trading centers could establish policies and procedures that could include regular exception reports to evaluate their trading practices. If a trading center's policies and procedures include exception reports, any such reports would need to be examined by the trading center to affirm that a trading center's policies and procedures have been followed by its personnel and properly coded into its automated systems and, if not, promptly identify the reasons and take remedial action.

To help ensure compliance with the proposed modified uptick rule, trading centers could also have policies and procedures that would enable a trading center to have a record identifying the current national best bid at the time of execution or display of a short sale order, as well as the last differently priced national best bid. Such ''snapshots'' of the market would aid SROs in evaluating a trading center's written policies and procedures and compliance with the proposed modified uptick rule. In addition, such snapshots would aid trading centers in verifying that a short sale order was priced in accordance with the provisions of proposed Rule 201(b)(1) if bid ''flickering,'' *i.e.,* rapid and repeated changes in the current national best bid during the period between identification of the current national best bid and the execution or display of the short sale order, creates confusion regarding whether or not the short sale order was executed or displayed at a permissible price. Snapshots of the market at the time of execution or display of an order would also aid trading centers in dealing with time lags in receiving data regarding the national best bid from different data sources. A trading center's policies and procedures would be required to address latencies in obtaining data regarding the national best bid. In addition, to the extent such latencies occur, a trading center's policies and procedures would need to implement reasonable steps to monitor such latencies on a continuing basis and take appropriate steps to address a problem should one develop.

Trading centers would be required to conduct surveillance under the proposed modified uptick rule. Proposed Rule 201(b)(2) provides that a trading center must regularly surveil to ascertain the effectiveness of the policies and procedures required under the proposed modified uptick rule and must take prompt action to remedy deficiencies in such policies and procedures.[120] This provision would reinforce the ongoing maintenance and enforcement requirements of proposed Rule 201(b)(1) by explicitly assigning an affirmative responsibility to trading centers to surveil to ascertain the effectiveness of their policies and procedures.[121] Thus, under the proposed modified uptick rule, trading centers would not be able to merely establish policies and procedures that may be reasonable when created and assume that such policies and procedures would continue to satisfy the requirements of proposed Rule 201(b). Rather, trading centers would be required to regularly assess the continuing effectiveness of their procedures and take prompt action when needed to remedy deficiencies. In particular, trading centers would need to engage in regular and periodic surveillance to determine whether executions or displays of short sale orders on impermissible bids are occurring without an applicable exception and whether the trading center has failed to implement and maintain policies and procedures that would have reasonably prevented such impermissible executions or displays of short sale orders.

The proposed modified uptick rule would differ from the tick test of former Rule 10a–1, and the alternative proposed uptick rule discussed below. Similar to former Rule 10a–1, the alternative proposed uptick rule would be based on the last sale price, rather than the national best bid, and it would not include an explicit policies and procedures requirement. The proposed uptick rule would prevent the execution of short sale orders below the last sale price, unless an exception applies. The proposed modified uptick rule would prevent the execution or display of short sale orders below the current national best bid, unless, among other things, the order is marked ''short exempt.'' Because the proposed modified uptick rule would use the national best bid as its reference point, short selling could occur below the last sale price.

The two proposed alternative short sale price tests would operate similarly, however, in that they would be designed to achieve a similar purpose. In addition, to help limit the impact of the proposed alternative short sale price tests on legitimate short selling, both rules would permit short selling at an increment above the national best bid, or the last sale price, as applicable, in a declining market. As commenters have noted, the higher the increment the more restrictive such an increment could be on short selling and could even be tantamount to a ban on short selling.[122]

In addition, the proposed modified uptick rule, similar to the proposed uptick rule, would not result in the type of disparate short sale regulation that existed under former Rule 10a–1.[123] The proposed modified uptick rule would apply a uniform rule to trades in the same securities that can occur in

[115] *See* Regulation NMS Adopting Release, 70 FR 37496; *see also* 17 CFR 242.611.

[116] *See id.*

[117] *See id.*

[118] *See* Section V below discussing short sale orders marked ''short exempt.''

[119] *See* proposed Rules 201(c) and 201(d).

[120] *See* proposed Rule 201(b)(2).

[121] We note that Rule 611(a)(2) of Regulation NMS contains a similar provision for trading centers. *See* 17 CFR 242.611(a)(2).

[122] *See supra* note 94; *see also* letter from Dan Mathisson, Managing Director, Credit Suisse Securities USA, LLC, dated March 30, 2009 (''letter from Credit Suisse'') (stating that ''requiring an uptick of more than one cent would be tantamount to a total ban for any stock that trades actively'').

[123] *See* proposed Rule 201(e).

multiple, dispersed, and diverse markets. One of the reasons for the elimination of former Rule 10a–1 and the prohibition on any SRO from having a short sale price test in July 2007 was because the application of short sale price tests had become disjointed with different price tests applying to the same securities trading in different markets. Under the proposed modified uptick rule, all covered securities, wherever traded, would be subject to one short sale price test, the proposed modified uptick rule. To further this goal of having a uniform short sale price test, subsection (e) of proposed Rule 201 would provide that no SRO shall have any rule that is not in conformity with, or conflicts with proposed Rule 201.[124] In addition, just as market participants would be familiar with the proposed uptick rule because it is a modified version of former Rule 10a–1 that was in existence for almost 70 years, market participants would also be familiar with using the current national best bid as a reference point because NASD's bid test, which was in existence from 1994 to mid-2007, was based on the current national best bid.[125]

We preliminarily believe that a short sale price test based on the national best bid would be more suitable to today's markets than a short sale price test based on the last sale price. Although we recognize that a quotation proposes a transaction, whereas the last trade price reflects an actual trade, we note that pursuant to Commission and SRO rules, quotations for all covered securities must be firm.[126] By requiring that quotations are firm, the Commission intended to ensure that quotations provide reliable information to the marketplace so that broker-dealers are able to make best execution decisions for their customers' orders and customers are able to make informed investment decisions.[127] Moreover, quotation information has significant value to the marketplace because it reflects the various factors affecting the market, including current levels of buying and selling interest.[128] Both retail and institutional investors rely on quotation information to understand the market forces at work at a given time and to assist in the formulation of investment strategies.[129]

Further, we believe that bids generally are a more accurate reflection of current prices for a security because changes in the national best bid are sequenced across trading centers. In contrast, transactions may be reported within a 90 second window, which can easily result in out-of-sequence reports. Even transactions that are executed and reported automatically may be out of sequence if they occur in different trading centers. For example, trade reporting for covered securities can involve multiple trading centers reporting trades in the same stock from different locations using different means of reporting. In addition, trades are published in reporting sequence, not trade sequence.[130] Thus, for those covered securities for which a significant amount of trading occurs manually, or in multiple trading centers, a price test based on the national best bid may be a fairer and more effective means of regulating short selling than a test based on the last sale price because the manner in which trades are reported may create up-ticks and down-ticks that may not accurately reflect actual price movements in the security for the purpose of a test based on the last sale price.

The proposed modified uptick rule would be designed to restrict short selling at successively lower prices and, thereby, might help prevent short selling, including potentially abusive or manipulative short selling, from being used as a tool to drive the markets down and from being used to accelerate a decline in the market by exhausting all remaining bids at one price level. By seeking to advance these goals, the proposed modified uptick rule might restore investor confidence in our securities markets.

In addition, the proposed modified uptick rule would be designed to preserve instant execution and liquidity by allowing relatively unrestricted short selling in an advancing market. As discussed above, one of the benefits of legitimate short selling is that it provides market liquidity by, for example, adding to the selling interest of stock available to purchasers, and, when sellers are covering their short sales, adding to the buying interest of stock available to sellers.

In addition, we believe the proposed modified uptick rule would accommodate trading systems and strategies used in the marketplace today, such as the automated trade matching systems that offer price improvement based on the national best bid and offer. These passive pricing systems often effect trades at an independently-derived price, such as at the mid-point of the bid-offer spread. Such pricing would often not satisfy the tick test of former Rule 10a–1 because matches could potentially occur at a price below the last reported sale price. Thus, we provided a limited exception from former Rule 10a–1 for these trading systems.[131] The proposed modified uptick rule would accommodate matching systems that execute trades at an independently derived price because such systems are designed so that matches occur above the current national best bid.[132] Thus, even in a declining market where a trading center could execute or display an order only if it is priced above the current national best bid at the time of execution or display, such matching system executions would comply with the proposed modified uptick rule.

If we were to adopt the proposed modified uptick rule, we are proposing that there would be a three month implementation period such that trading centers would have to comply with the proposed modified uptick rule three months following the effective date of the proposed modified uptick rule. We believe that a proposed three month implementation period would provide trading centers with sufficient time in which to modify their systems and procedures in order to comply with the requirements of the proposed modified uptick rule. Because the proposed modified uptick rule would require the implementation of policies and procedures similar to those required for trading centers under Regulation NMS, we believe that a three month implementation period would be reasonable. The addition of an implementation period should alleviate any potential disruptive effects of the proposal.

We realize, however, that a shorter or longer implementation period may be manageable or preferable. In the Solicitation of Comment below, we seek specific comment as to what length of implementation period would be necessary or appropriate, and why, such that trading centers would be able to

[124] *See* proposed Rule 201(e).

[125] *See supra* note 27 (discussing NASD Rule 3350). Similar to the proposed modified uptick rule, NASD's bid test referenced the national best bid and was designed to help prevent short selling at or below the current national best bid in a declining market. NASD's bid test, however, took a straight prohibition approach, rather than a policies and procedures approach, and, by its terms, applied only to Nasdaq Global Market securities.

[126] *See e.g.,* 17 CFR 242.602.

[127] *See* Securities Exchange Act Release No. 43085 (July 28, 2000), 65 FR 47918 (Aug. 4, 2000).

[128] *See id.*

[129] *See id.*

[130] *See* FINRA Rule 6380A.

[131] *See, e.g., supra* note 26.

[132] *See id.*; *see e.g.,* letter from James A. Brigagliano, Acting Associate Director, Division of Market Regulation, to Alan J. Reed, Jr., First Vice President and Director of Compliance, Instinet Group, LLC. (June 15, 2006) (granting Instinet modified exemptive relief from Rule 10a–1 for certain transactions executed through Instinet's Intraday Crossing System); POSIT letter.

meet the proposed short sale price test restrictions, if adopted.

2. ''Short Exempt'' Provision of Proposed Modified Uptick Rule

Paragraph (b)(1)(ii) of the proposed modified uptick rule provides that a trading center's policies and procedures must be reasonably designed to permit the execution or display of a short sale order of a covered security marked ''short exempt'' without regard to whether the order is at a down-bid price.[133] Thus, a trading center's policies and procedures must be reasonably designed to recognize when an order is marked ''short exempt'' so that the trading center's policies and procedures would not prevent the execution or display of such orders on a down-bid price.[134]

As discussed in more detail below, proposed Rule 200(g)(2) of Regulation SHO provides that a sale order shall be marked ''short exempt'' only if the provisions of paragraph (c) or (d) of proposed Rule 201 are met.[135] Paragraphs (c) and (d) of the proposed modified uptick rule set forth when a broker-dealer may mark a short sale order ''short exempt.'' The provisions contained in paragraphs (c) and (d) of the proposed modified uptick rule are designed to promote the workability of the proposed modified uptick rule, while at the same time furthering the Commission's stated goals.

In addition, we note that the provisions contained in paragraph (d) of proposed Rule 201 would parallel exceptions to former Rule 10a–1 and exemptive relief granted pursuant to that rule. These exceptions and exemptions from former Rule 10a–1, as applicable, had been in place under former Rule 10a–1 for several years. We are not aware of any reason that the rationales underlying these exceptions and exemptions from former Rule 10a–1 would not still hold true today. Moreover, due to the limited scope of these exceptions and exemptions to former Rule 10a–1, we do not believe that including provisions that would parallel these exceptions and exemptions to former Rule 10a–1 would undermine the Commission's stated goals for proposing short sale price test restrictions.

Thus, the provisions in proposed Rule 201(d) parallel exceptions to and exemptive relief granted under former Rule 10a–1, as applicable.[136] As set forth in more detail below, however, we seek comment regarding each of these provisions, including whether or not these provisions would be appropriate or necessary under the proposed modified uptick rule.

a. Broker-Dealer Provision

Proposed Rule 201(c) provides that a broker-dealer may mark a short sale order of a covered security ''short exempt'' if a broker-dealer that submits a short sale order to a trading center identifies that the short sale order is not on a down-bid price at the time of submission of the order to the trading center.[137] The proposed rule would require any broker-dealer relying on this provision to establish, maintain, and enforce written policies and procedures that are reasonably designed to prevent the incorrect identification of orders as being priced in accordance with the requirements of proposed Rule 201(c)(1).[138]

We are proposing this provision to provide broker-dealers with the option to manage their order flow, rather than having to always rely on their trading centers to manage their order flow on their behalf. In addition, we note that this provision would not undermine the Commission's goals for short sale regulation because any broker-dealer marking an order ''short exempt'' in accordance with this provision would have to address whether its short sale order was not on a down-bid price at the time of submission of the order to a trading center.

As discussed in more detail below, we are proposing amendments to Rule 200(g) of Regulation SHO to require, in part, that a sale order shall be marked ''short exempt'' only if the provisions of paragraph (c) of proposed Rule 201 of the proposed modified uptick rule are met.[139]

To mark an order ''short exempt'' pursuant to paragraph (c) of the proposed modified uptick rule, the broker-dealer must have mechanisms in place to enable the broker-dealer to identify the short sale order as priced in accordance with the provisions of proposed Rule 201(c)(1). In accordance with proposed Rule 201(c)(1), these mechanisms must include written policies and procedures reasonably designed to prevent the incorrect identification of orders as being permissibly priced in accordance with the provisions of proposed Rule 201(c)(1).[140] Thus, although a broker-dealer relying on this provision in marking an order ''short exempt'' would not need to identify the order as permissibly priced to the trading center, it would need to have written policies and procedures in place reasonably designed to enable it to identify that an order was permissibly priced at the time of submission of the order to a trading center.[141]

At a minimum, a broker-dealer's policies and procedures would need to be reasonably designed to enable a broker-dealer to monitor, on a real-time basis, the national best bid, and whether the current national best bid is an up- or down-bid from the last differently priced national best bid, so as to determine the price at which the broker-dealer may submit a short sale order to a trading center in compliance with the provisions of proposed Rule 201(c)(1).

A broker-dealer would also need to take such steps as would be necessary to enable it to enforce its policies and procedures effectively.[142] For example, broker-dealers could establish policies and procedures that could include regular exception reports to evaluate their trading practices. If a broker-dealer's policies and procedures include exception reports, any such reports would need to be examined to affirm that a broker-dealer's policies and procedures have been followed by its personnel and properly coded into its automated systems and, if not, promptly identify the reasons and take remedial action.

To ensure compliance with proposed Rule 201(c)(1), a broker-dealer could also have policies and procedures that would enable it to have a record identifying the current national best bid at the time of submission of a short sale order, as well as the last differently priced national best bid. Such ''snapshots'' of the market would also aid SROs in evaluating a broker-dealer's written policies and procedures and compliance with proposed Rule 201(c). In addition, such snapshots would aid broker-dealers in verifying that a short sale order was priced in accordance with the provisions of proposed Rule 201(c)(1) if bid flickering during the period between identification of the current national best bid and the

[133] *See* proposed Rule 201(b)(1)(ii).

[134] *See* proposed Rule 201(b)(1)(ii).

[135] *See* Section V below discussing proposed Rule 200(g)(2).

[136] We note that NASD Rule 3350 contained exceptions to that rule similar to exceptions to former Rule 10a–1. In addition, we note NASD Rule 3350 included an exception related to bona fide market making activity. *See infra* note 190 and accompanying text (discussing our decision not to propose that a broker-dealer may mark an order ''short exempt'' in connection with bona fide market making activity). *See also supra* note 125.

[137] *See* proposed Rule 201(c)(1).

[138] *See* proposed Rule 201(c)(1).

[139] *See* proposed Rule 200(g)(2).

[140] *See* proposed Rule 201(c)(1).

[141] Such policies and procedures would be similar to those required for trading centers complying with paragraph (b) of the proposed modified uptick rule.

[142] *See* proposed Rule 201(c)(1).

submission of the short sale order to a trading center creates confusion regarding whether or not the short sale order was submitted at a permissible price. Snapshots of the market at the time of submission of an order would also aid broker-dealers in dealing with time lags in receiving data regarding the national best bid from different data sources. A broker-dealer's policies and procedures would be required to address any such latencies in obtaining data regarding the national best bid. In addition, to the extent such latencies occur, a broker-dealer's policies and procedures would need to implement reasonable steps to monitor such latencies on a continuing basis and take appropriate steps to address a problem should one develop.

Surveillance would be a required part of a broker-dealer's satisfaction of its legal obligations. Proposed Rule 201(c)(1) provides that a broker-dealer must regularly surveil to ascertain the effectiveness of the policies and procedures required under proposed Rule 201(c)(2) and must take prompt action to remedy deficiencies in such policies and procedures.[143] This provision would reinforce the ongoing maintenance and enforcement requirements of proposed Rule 201(c)(2) by explicitly assigning an affirmative responsibility to broker-dealers to surveil to ascertain the effectiveness of their policies and procedures.[144] Thus, under proposed Rule 201(c)(1) and (c)(2), broker-dealers would not be able to merely establish policies and procedures that may be reasonable when created and assume that such policies and procedures would continue to satisfy the requirements of the proposed rule. Rather, broker-dealers would be required to regularly assess the continuing effectiveness of their procedures and take prompt action when needed to remedy deficiencies. In particular, each broker-dealer would need to engage in regular and periodic surveillance to determine whether it is submitting short sale orders marked ''short exempt'' without complying with the requirements of proposed Rule 201(c)(1) and whether the broker-dealer has failed to implement and maintain policies and procedures that would have reasonably prevented such impermissible submissions.

b. Seller's Delay in Delivery

The proposed modified uptick rule provides that a broker-dealer may mark an order ''short exempt'' if the broker-dealer has a reasonable basis to believe that the seller owns the security being sold and that the seller intends to deliver the security as soon as all restrictions on delivery have been removed.[145] Specifically, proposed Rule 201(d)(1) provides that a broker-dealer may mark a short sale order of a covered security ''short exempt'' if the broker-dealer has a reasonable basis to believe the short sale order of a covered security is by a person that is deemed to own the covered security pursuant to Rule 200 of Regulation SHO,[146] provided that the person intends to deliver the security as soon as all restrictions on delivery have been removed.[147]

Rule 200(g)(1) of Regulation SHO provides that a sale can be marked ''long'' only if the seller is deemed to own the security being sold and either (i) the security is in the broker-dealer's physical possession or control, or (ii) it is reasonably expected that the security will be in the broker-dealer's physical possession or control by settlement of the transaction.[148] Thus, even where a seller owns a security, if delivery will be delayed, such as in the sale of formerly restricted securities pursuant to Rule 144 of the Securities Act of 1933, or where a convertible security, option, or warrant has been tendered for conversion or exchange, but the underlying security is not reasonably expected to be received by settlement date, such sales must be marked ''short.'' As a result, proposed Rule 201(d)(1) would be necessary to allow for sales of securities that although owned, are subject to the provisions of Regulation SHO governing short sales due solely to the seller being unable to deliver the security to its broker-dealer prior to settlement based on circumstances outside the seller's control.

c. Odd Lot Transactions

Proposed Rule 201(d)(2) would provide that a broker-dealer may mark a short sale order ''short exempt'' if the broker-dealer has a reasonable basis to believe that the short sale order is by a market maker to off-set a customer odd-lot[149] order or liquidate an odd-lot position which changes such broker-dealer's position by no more than a unit of trading.[150]

Under former Rule 10a–1, an exception for certain odd-lot transactions was created in an effort to reduce the burden and inconvenience that short sale restrictions would place on odd-lot transactions. In 1938, the Commission found that odd-lot transactions played a very minor role in potential manipulation by short selling. Initially, sales of odd-lots were not subject to the restrictions of Rule 10a–1.[151] However, the Commission became concerned over the volume of odd-lot transactions, which possibly indicated that the exception was being used to circumvent the rule. As a result, the exception was changed to include the two odd lot exceptions described below.[152]

Former Rule 10a–1(e)(3) contained a limited exception for odd-lot dealers registered in the security and third market makers. The exception allowed short sales by odd-lot dealers registered in the security and by third market makers of covered securities to fill customer odd lot orders. Former Rule 10a–1(e)(4) provided an exception under the rule for any sale to liquidate an odd-lot position by a single round lot sell order that changed the broker-dealer's position by no more than a unit of trading.

We believe that a provision that would allow a broker-dealer to mark a short sale order ''short exempt'' if it has a reasonable basis to believe that the

[143] *See* proposed Rule 201(c)(2).

[144] We note that Rule 611(a)(2) of Regulation NMS contains a similar surveillance provision. *See* 17 CFR 242.611(a)(2).

[145] Subsection (e)(1) of former Rule 10a–1 contained an exception relating to a seller's delay in the delivery of securities. The provision in proposed Rule 201(d)(1) parallels the exception contained in former Rule 10a–1(e)(1).

[146] 17 CFR 242.200.

[147] *See* proposed Rule 201(d)(1). This proposed provision is also consistent with Rule 203(b)(2)(ii) of Regulation SHO that provides an exception from the ''locate'' requirement of Rule 203(b)(1) of Regulation SHO for ''[a]ny sale of a security that a person is deemed to own pursuant to § 242.200, provided that the broker or dealer has been reasonably informed that the person intends to deliver such security as soon as all restrictions on delivery have been removed * * *'' 17 CFR 242.203(b)(2)(ii).

[148] *See* 17 CFR 242.200(g)(1).

[149] Proposed Rule 201(a)(5) provides that the term ''odd lot'' shall have the same meaning as in 17 CFR 242.600(b)(49). Rule 600(b)(49) defines an ''odd lot'' as ''an order for the purchase or sale of an NMS stock in an amount less than a round lot.'' 17 CFR 242.600(b)(49).

[150] *See* proposed Rule 201(d)(2). SRO rules define a ''unit of trading'' or ''normal unit of trading,'' and generally means 100 shares, *i.e.*, a round lot. For example, FINRA Rule 6320A(7) defines a ''normal unit of trading'' to mean ''100 shares of a security unless, with respect to a particular security, FINRA determines that a normal unit of trading shall constitute other than 100 shares.'' NYSE Rule 55 states that ''[t]he unit of trading in stocks shall be 100 shares, except that in the case of certain stocks designated by the Exchange the unit of trading shall be such lesser number of shares as may be determined by the Exchange, with respect to each stock so designated * * *.''

[151] The Commission initially adopted three exceptions for odd-lot transactions. While the first one, excepting all odd-lot transactions, seemed to make other odd-lot exceptions unnecessary, the 1938 adopting release included all three exceptions without discussion. *See supra* note 24, Former Rule 10a–1 Adopting Release 3 FR 213.

[152] *See* Securities Exchange Act Release No. 11030 (Sept. 27, 1974), 39 FR 35570 (Oct. 2, 1974).

short sale order is by a market maker to off-set a customer odd-lot order or liquidate an odd-lot position which changes such broker-dealer's position by no more than a unit of trading would continue to be of utility under the proposed modified uptick rule because it would not be in conflict with the goals of the proposed rule.

Thus, the provision in proposed Rule 201(d)(2) parallels the exceptions in subsections (e)(3) and (e)(4) of former Rule 10a–1. In addition, however, we propose extending the provision to cover all market makers acting in the capacity of an odd-lot dealer. When former Rule 10a–1 was adopted, odd-lot dealers dealt exclusively with odd-lot transactions, and were so registered. Today, market makers registered in a security typically also act as odd-lot dealers of the security. Thus, we propose to broaden the provision in proposed Rule 201(d)(2) to all broker-dealers acting as ''market makers'' in odd lots.[153]

We believe that this provision would be appropriate. Because odd-lot transactions by market makers to facilitate customer orders are not of a size that could facilitate a downward movement in the market, we do not believe that proposed Rule 201(d)(2) would adversely affect the goals of short sale regulation that the proposed modified uptick rule seeks to advance. Thus, we believe that a broker-dealer should be able to mark such orders ''short exempt'' so that those acting in the capacity of a ''market maker,'' with the commensurate negative and positive obligations, would be able to off-set a customer odd-lot order and liquidate an odd-lot position without a trading center's policies and procedures preventing the execution or display of such orders at a down-bid price.

d. Domestic Arbitrage

Proposed Rule 201(d)(3) would provide that a broker-dealer may mark ''short exempt'' short sale orders associated with certain bona fide domestic arbitrage transactions. Subsection (e)(7) of former Rule 10a–1 contained an exception related to domestic arbitrage.[154] That exception applied to bona fide arbitrage undertaken to profit from a current difference in price between a convertible security and the underlying common stock.[155] The term ''bona fide arbitrage'' describes an activity undertaken by market professionals in which essentially contemporaneous purchases and sales are effected in order to lock in a gross profit or spread resulting from a current differential in pricing of two related securities.[156] For example, a person may sell short securities to profit from a current price differential based upon a convertible security that entitles him to acquire an equivalent number of securities of the securities sold short. We continue to believe that bona fide arbitrage activities are beneficial to the markets because they tend to reduce pricing disparities between related securities.[157] Thus, bona fide arbitrage transactions promote market efficiency.

Proposed Rule 201(d)(3) would parallel the exception in former Rule 10a–1(e)(7). Specifically, proposed Rule 201(d)(3) would provide that a broker-dealer may mark a short sale order of a covered security ''short exempt'' if the broker-dealer has a reasonable basis to believe that the short sale order is ''for a good faith account by a person who owns another security by virtue of which he is, or presently will be, entitled to acquire an equivalent number of securities of the same class as the securities sold, provided such sale, or the purchase which such sale offsets, is effected for the bona fide purpose of profiting from the difference between the price of the security sold and the security owned and that such right of acquisition was originally attached to or represented by another security or was issued to all the holders of any such securities of the issuer.'' [158]

The domestic arbitrage exception in former Rule 10a–1 was intended to be consistent with the arbitrage provision of Regulation T.[159] Thus, consistent with that provision, former Rule 10a–1(e)(7) referred to a ''special arbitrage account'' and not a ''good faith account.'' [160] The Federal Reserve Board amended Regulation T in 1998 to eliminate the ''special arbitrage account'' and allow the functions formerly effected in that account to be effected in a ''good faith account.'' Thus, proposed Rule 201(d)(3) also refers to a ''good faith account.'' We note, however, that we request specific comment regarding whether or not the use of a ''good faith account'' or any other separate account continues to be appropriate or necessary for purposes of this proposed Rule 201(d)(3).

Because allowing domestic arbitrage at a down-bid price would potentially promote market efficiency, the proposed modified uptick rule would include a limited provision to allow broker-dealers to mark short sale orders ''short exempt'' provided the broker-dealer has a reasonable basis to believe that the conditions in proposed Rule 201(d)(3) have been met. Thus, the proposed rule is designed to permit the execution or display on a down-bid price of such orders in connection with bona fide arbitrage transactions involving convertible, exchangeable, and other rights to acquire the securities sold short, where such rights of acquisition were originally attached to, or represented by, another security, or were issued to all the holders of any such class of securities of the issuer.

e. International Arbitrage

Proposed Rule 201(d)(4) would provide that a broker-dealer may mark ''short exempt'' short sale orders associated with certain international arbitrage transactions. Former Rule 10a–1(e)(8) included an international arbitrage exception that was adopted in 1939.[161] In adopting the exception, the Commission stated that it was necessary

[153] Section 3(a)(38) of the Exchange Act defines a ''market maker,'' and includes specialists. *See* 15 U.S.C. 78c(a)(38).

[154] *See* Securities Exchange Act Release No. 1645 (Apr. 8, 1938).

[155] *See* Securities Exchange Act Release No. 42037 (Oct. 20, 1999), 64 FR 57996 (Oct. 28, 1999) (''1999 Concept Release'').

[156] 1999 Concept Release, 64 FR at n.54 and accompanying text (discussing the domestic arbitrage exception under former Rule 10a–1). *See also* Section 220.6(b) of Regulation T which states that the term ''bona fide arbitrage'' means: ''(1) A purchase or sale of a security in one market together with an offsetting sale or purchase of the same security in a different market at as nearly the same time as practicable for the purpose of taking advantage of a difference in prices in the two markets; or (2) A purchase of a security which is, without restriction other than the payment of money, exchangeable or convertible within 90 calendar days of the purchase into a second security together with an offsetting sale of the second security at or about the same time, for the purpose of taking advantage of a concurrent disparity in the prices of the two securities.'' 12 CFR 220.6(b). *See also* Securities Exchange Act Release No. 15533 (Jan. 29, 1979), 44 FR 6084 (Jan. 31, 1979) (interpretation concerning the application of Section 11(a)(1) to bona fide arbitrage).

[157] *See* Securities Exchange Act Release No. 15533 (Jan. 29, 1979), 44 FR 6084 (Jan. 31, 1979) (interpretation concerning the application of Section 11(a)(1) to bona fide arbitrage).

[158] Proposed Rule 201(d)(3).

[159] *See* 12 CFR 220.6.

[160] Section 220.3(b) of Regulation T, titled ''Separation of accounts,'' generally provides that requirements for an account may not be met by considering items in any other account. Further, Regulation T identifies three types of customer accounts—cash accounts, margin accounts and good faith accounts—in which customer transactions may be booked. A broker-dealer can extend credit to customers through a margin account or a good faith account. Generally, positions held in a good faith account are subject to good faith margin, whereas positions held in a margin account are subject to the margin requirements otherwise set forth in Regulation T and SRO margin requirements.

[161] *See* Securities Exchange Act Release No. 2039 (Mar. 10, 1939), 4 FR 1209 (Mar. 14, 1939).

to facilitate ''transactions which are of a true arbitrage nature, namely, transactions in which a position is taken on one exchange which is to be immediately covered on a foreign market.'' [162] We believe likewise that such transactions would have utility under the proposed modified uptick rule. As discussed above in connection with domestic arbitrage, bona fide arbitrage transactions promote market efficiency because they equalize prices at an instant in time in different markets or between relatively equivalent securities. Thus, we do not believe that permitting broker-dealers to mark these orders ''short exempt'' would undermine the goals of short sale price test regulation.

Proposed Rule 201(d)(4) would parallel the exception contained in former Rule 10a–1(e)(8). Specifically, proposed Rule 201(d)(4) would provide that a broker-dealer may mark a short sale order of a covered security ''short exempt'' if the broker-dealer has a reasonable basis to believe that the short sale order is ''for a good faith account submitted to profit from a current price difference between a security on a foreign securities market and a security on a securities market subject to the jurisdiction of the United States, provided that the short seller has an offer to buy on a foreign market that allows the seller to immediately cover the short sale at the time it was made.'' [163]

In proposed Rule 201(d)(4), we have simplified the language of former Rule 10a–1(e)(8) to make it more understandable.[164] In addition, we have changed the reference in former Rule 10a–1(e)(8) from a ''special international arbitrage account'' to a ''good faith account.'' As discussed above in connection with the domestic arbitrage provision of proposed Rule 201(d)(3), this revision is necessary to make the proposed provision consistent with the arbitrage provision in Regulation T. We note, however, that we request specific comment regarding whether or not the use of a ''good faith account'' or any other separate account continues to be appropriate or necessary for purposes of proposed Rule 201(d)(4).

In addition, we have incorporated language from the exception in former Rule 10a–1(e)(12) that provided that, for purposes of the international arbitrage exception, a depository receipt for a security shall be deemed to be the same security represented by the receipt. This language was originally included in the Commission's 1939 release adopting the international arbitrage exception, but was incorporated separately in former Rule 10a–1(e)(12).[165] We likewise believe this language is appropriate and should be incorporated into proposed Rule 201(d)(4). We seek comment, however, regarding whether for purposes of the international arbitrage provision, a depository receipt for a security should be deemed to be the same security represented by the receipt.

As with the exception in former Rule 10a–1(e)(8), proposed Rule 201(d)(4) would apply only to bona fide arbitrage transactions. Thus, this provision would only be applicable if at the time of the short sale there is a corresponding offer in a foreign securities market, so that the immediate covering purchase would have the effect of neutralizing the short sale. We believe proposed Rule 201(d)(4) would be necessary to facilitate arbitrage transactions in which a position is taken in a security in the U.S. market, and which is to be immediately covered in a foreign market.[166]

f. Over-Allotments and Lay-Off Sales

Proposed Rule 201(d)(5) would provide that a broker-dealer may mark ''short exempt'' short sale orders by underwriters or syndicate members participating in a distribution in connection with an over-allotment, and any short sale orders with respect to lay-off sales by such persons in connection with a distribution of securities through a rights or standby underwriting commitment.

Former Rule 10a–1(e)(10) contained an exception for over-allotment and lay-off sales.[167] Although the exception was not adopted until 1974, the Commission's approval of the concept of excepting over-allotments and lay-off sales from short sale rules is long-standing.[168] In addition, we note that recently we excepted these sales from the July Emergency Order, which among other things required that short sellers borrow or arrange to borrow securities prior to effecting a short sale, stating that it was not necessary for the Order to cover such sales because such activity is covered by Regulation M under the Exchange Act,[169] an anti-manipulation rule.[170] In accordance with the long-standing Commission position regarding these sales, we are including through proposed Rule 201(d)(5) a provision for short sale orders in connection with over-allotment and lay-off sales that would parallel the exception in former Rule 10a–1(e)(10).

g. Riskless Principal Transactions

Proposed Rule 201(d)(6) would provide that a broker-dealer may mark ''short exempt'' short sale orders where broker-dealers are facilitating customer buy orders or sell orders where the customer is net long, and the broker-dealer is net short but is effecting the sale as riskless principal.[171]

In 2005, the Commission granted exemptive relief under former Rule 10a–1 for any broker-dealer that facilitates a customer buy or long sell order on a riskless principal basis.[172] In granting the relief, the Commission noted representations made in the letter requesting relief that in the situation where the amount of securities that the broker-dealer purchases for the customer may not be sufficient to give the broker-dealer an overall net ''long'' position, former Rule 10a–1 would constrain the ability of the broker-dealer to fill the customer buy order. Further, the Commission noted representations in the letter requesting relief that because such short sales would be effected only in response to a customer buy order, this should vitiate any concerns about such sales having a depressing impact on the security's price.[173]

In addition, the Commission noted representations made in the letter

[162] *See id.*

[163] Proposed Rule 201(d)(4).

[164] Former Rule 10a–1(e)(8) provided that the short sale price test restrictions of that rule shall not apply to: ''Any sale of a security registered on, or admitted to unlisted trading privileges on, a national securities exchange effected for a special international arbitrage account for the bona fide purpose of profiting [sic] from a current difference between the price of such security on a securities market not within or subject to the jurisdiction of the United States and on a securities market subject to the jurisdiction of the United States; provided the seller at the time of such sale knows or, by virtue of information currently received, has reasonable grounds to believe that an offer enabling him to cover such sale is then available to him such foreign securities market and intends to accept such offer immediately.''

[165] *See supra* note 161.

[166] We note that the requirement that the transaction be ''immediately'' covered on a foreign market requires the foreign market to be open for trading at the time of the transaction. *See* 2003 Regulation SHO Proposing Release, 68 FR at 62986.

[167] *See* Securities Exchange Act Release No. 11030 (Sept. 7, 1974), 39 FR 35570 (Oct. 2, 1974).

[168] *See, e.g.,* Securities Exchange Act Release No. 3454 (July 6, 1946), in which the Commission approved the NYSE's special offering plan, which permitted short sales in the form of over-allotments to facilitate market stabilization.

[169] 17 CFR 242.100 *et seq.*

[170] *See* Securities Exchange Act Release No. 58190 (July 18, 2008), 73 FR 42837 (July 23, 2008) (amending the July Emergency Order to include exceptions for certain short sales).

[171] *See* proposed Rule 201(d)(6).

[172] *See* letter from James A. Brigagliano to Ira Hammerman, Senior Vice President and General Counsel, Securities Industry Association, dated July 18, 2005 (''Riskless Principal Letter'').

[173] *See id.*

requesting relief that where a broker-dealer is facilitating a customer long sale order in a riskless principal transaction, because the ultimate seller is long the shares being sold, these transactions present none of the potential abuses that former Rule 10a–1 was designed to address.[174] The Commission also noted representations that the application of former Rule 10a–1 to riskless principal transactions involving a customer long sale can inhibit the broker-dealer's ability to provide timely (or any) execution to such customer long sale. Specifically, if the broker-dealer has a net short position, the broker-dealer will be restricted from executing its own principal trade to complete the first leg of the riskless principal transaction.[175] Thus, compliance with former Rule 10a–1 would adversely affect a broker-dealer's ability to provide best execution to a customer order.[176]

Consistent with the relief granted in the Riskless Principal Letter, we believe that including a provision to permit a broker-dealer to mark ''short exempt'' short sale orders in connection with riskless principal transactions would be appropriate and would not undermine our goals in proposing short sale price test regulation. In particular, we note that such a provision would facilitate a broker-dealer's ability to provide best execution to customer orders. Accordingly, taken together proposed Rules 201(a)(6) and (d)(6) would parallel the conditions for relief in the Riskless Principal Letter.[177]

Specifically, proposed Rule 201(a)(6) would define the term ''riskless principal'' to mean ''a transaction in which a broker or dealer, after having received an order to buy a security, purchases the security as principal at the same price to satisfy the order to buy or, after having received an order to sell, sells the security as principal at the same price to satisfy the order to sell.'' [178] Proposed Rule 201(d)(6) would provide that a broker-dealer may mark a short sale order ''short exempt'' if the broker-dealer has a reasonable basis to believe that the short sale order is to effect the execution of a customer purchase or the execution of a customer ''long'' sale on a riskless principal basis and provided the sell order is given the same per-share price at which the broker-dealer bought shares to satisfy the facilitated order, exclusive of any explicitly disclosed markup or markdown, commission equivalent or other fee.[179] In addition, proposed Rule 201(d)(6) would require the broker-dealer, if it marks an order ''short exempt'' under this provision, to have policies and procedures in place to assure that, at a minimum: the customer order was received prior to the offsetting transaction; the offsetting transaction is allocated to a riskless principal or customer account within 60 seconds of execution; and that it has supervisory systems in place to produce records that enable the broker-dealer to accurately and readily reconstruct, in a time-sequenced manner, all orders on which the broker-dealer relies pursuant to this provision.[180]

We believe that proposed Rule 201(d)(6) would provide broker-dealers with additional flexibility to facilitate customer orders and provide best execution. In addition, we believe that the conditions set forth in proposed Rule 201(d)(6) would provide a mechanism for the surveillance of the provision's use by linking it to specific incoming orders and executions, and by requiring broker-dealers to establish procedures for handling such transactions. These requirements would help ensure that broker-dealers are complying with proposed Rule 201(d)(6).

h. Transactions on a Volume-Weighted Average Price Basis

Proposed Rule 201(d)(7) would provide that a broker-dealer may mark ''short exempt'' certain sale orders executed on a volume-weighted average price (''VWAP'') basis. Under former Rule 10a–1, the Commission granted limited relief from that rule in connection with short sales executed on a VWAP basis.[181] The relief was limited to VWAP transactions that are arranged or ''matched'' before the market opens at 9:30 a.m., but are not assigned a price until after the close of trading when the VWAP value is calculated. The Commission granted the exemptions based, in part, on the fact that these VWAP short sale transactions appeared to pose little risk of facilitating the type of market effects that former Rule 10a–1 was designed to prevent.[182] In particular, the Commission noted that the pre-opening VWAP short sale transactions do not participate in or affect the determination of the VWAP for a particular security.[183] Moreover, the Commission stated that all trades used to calculate the day's VWAP would continue to be subject to former Rule 10a–1.[184]

Consistent with the relief granted under former Rule 10a–1, we propose providing that a broker-dealer may mark ''short exempt'' certain short sale orders executed at the VWAP. Proposed Rule 201(d)(7) would differ from the relief granted under former Rule 10a–1, however, in that it would not be limited to VWAP transactions that are arranged or ''matched'' before the market opens at 9:30 a.m., or that are not assigned a price until after the close of trading when the VWAP value is calculated. We believe this restriction would not be necessary because VWAP short sale transactions appear to pose little risk of facilitating the type of market effects that a short sale price test restriction would be designed to prevent. In addition, in accordance with proposed Rule 201(d)(7), no short sale orders used to calculate the VWAP may be marked ''short exempt.'' [185] This would help limit any potential for manipulation.

Thus, pursuant to proposed Rule 201(d)(7), a broker-dealer may mark a short sale order of a covered security ''short exempt'' if the broker-dealer has a reasonable basis to believe that the short sale order is for the sale of a covered security at the VWAP that meets the following conditions: [186] (1) The VWAP for the covered security is calculated by: Calculating the values for every regular way trade reported in the consolidated system for the security during the regular trading session, by multiplying each such price by the total

[174] *See id.*

[175] *See id.*

[176] *See id.*

[177] These conditions are also consistent with the definition of ''riskless principal transactions'' under Rule 10b–18 of the Exchange Act. *See* 17 CFR 240.10b–18(a)(12).

[178] In addition to being consistent with the conditions in the Riskless Principal Letter and Rule 10b–18 of the Exchange Act, this definition is consistent with the definition of ''riskless principal'' in FINRA Rule 6642.

[179] This requirement is also consistent with FINRA's trade reporting rules which require a riskless principal transaction in which both legs are executed at the same price to be reported once, in the same manner as an agency transaction, exclusive of any markup, markdown, commission equivalent, or other fee. *See* FINRA Rule 6380A(d)(3)(B).

[180] *See* proposed Rule 201(d)(6).

[181] *See e.g.* letter from Larry E. Bergmann, Senior Associate Director, Division of Market Regulation, SEC, to Edith Hallahan, Counsel, Phlx, dated March 24, 1999; letter from Larry E. Bergmann, Senior Associate Director, Division of Market Regulation, SEC, to Soo J. Yim, Wilmer, Cutler & Pickering, dated December 7, 2000; letter from James Brigagliano, Assistant Director, Division of Market Regulation, SEC, to Andre E. Owens, Schiff Hardin & Waite, dated March 30, 2001; letter from James Brigagliano, Assistant Director, Division of Market Regulation, SEC, to Sam Scott Miller, Esq., Orrick, Herrington & Sutcliffe LLP, dated May 12, 2001; letter from James Brigagliano, Assistant Director, Division of Market Regulation, SEC, to William W. Uchimoto, Esq., Vie Institutional Services, dated February 12, 2003.

[182] *See id.*

[183] *See id.*

[184] *See id.*

[185] *See* proposed Rule 201(b)(7).

[186] *See* proposed Rule 201(d)(7).

number of shares traded at that price; compiling an aggregate sum of all values; and dividing the aggregate sum by the total number of reported shares for that day in the security; (2) the transactions are reported using a special VWAP trade modifier; (3) no short sales used to calculate the VWAP are marked ''short exempt''; (4) the VWAP matched security qualifies as an ''actively traded security'' (as defined under Rules 101(c)(1) and 102(d)(1) of Regulation M), or where the subject listed security is not an ''actively traded security,'' the proposed short sale transaction will be permitted only if it is conducted as part of a basket transaction of twenty or more securities in which the subject security does not comprise more than 5% of the value of the basket traded; (5) the transaction is not effected for the purpose of creating actual, or apparent, active trading in or otherwise affecting the price of any security; and (6) a broker or dealer will act as principal on the contra-side to fill customer short sale orders only if the broker-dealer's position in the subject security, as committed by the broker-dealer during the pre-opening period of a trading day and aggregated across all of its customers who propose to sell short the same security on a VWAP basis, does not exceed 10% of the covered security's relevant average daily trading volume, as defined in Regulation M.[187]

Except as discussed above, the conditions set forth in proposed Rule 201(d)(7) parallel the conditions contained in the exemptive relief from former Rule 10a–1 granted for VWAP short sale transactions. We believe that these conditions worked well in restricting the exemptive relief to situations that generally would not raise the harms that short sale price tests are designed to prevent. We believe they would be similarly effective in serving that function today and, therefore, should be incorporated into proposed Rule 201(d)(7).

i. Decision Not To Propose That a Broker-Dealer May Mark an Order ''Short Exempt'' in Connection With Bona Fide Market Making Activity

Former Rule 10a–1(e)(5) provided a limited exception from the restrictions of that rule for ''[a]ny sale * * * by a registered specialist or registered exchange market maker for its own account on any exchange with which it is registered for such security, or by a third market maker for its own account over-the-counter, (i) Effected at a price equal to or above the last sale, regular way, reported for such security pursuant to an effective transaction reporting plan. * * * *Provided, however,* That any exchange, by rule, may prohibit its registered specialist and registered exchange market makers from availing themselves of the exemption afforded by this paragraph (e)(5) if that exchange determines that such action is necessary or appropriate in its market in the public interest or for the protection of investors.'' Unless prohibited by exchange rule, this exception was intended to permit registered specialists or market makers to protect customer orders against transactions in other markets in the consolidated system by allowing them to sell short at a price equal to the last trade price reported to the consolidated system, even if that sale was on a minus or zero-minus tick.[188] Although former Rule 10a–1 included this exception for market makers, exchanges adopted rules that prohibited their registered specialists and market makers from availing themselves of this exception.[189] In addition, former Rule 10a–1 did not contain a general exception for short selling in connection with bona fide market making activities.[190]

Consistent with former Rule 10a–1, the proposed modified uptick rule would not permit a broker-dealer to mark a short sale order ''short exempt'' if the broker-dealer is engaging in bona fide market making activity. By requiring trading centers to have policies and procedures reasonably designed to prevent the execution or display of a short sale order at a down-bid price, the proposed modified uptick rule might help prevent short selling, including potentially abusive or manipulative short selling, from being used as a tool to drive down a market and from being used to accelerate a declining market by exhausting all remaining bids at one price level, and causing successively lower prices to be established by long sellers. By seeking to advance these goals, the proposed modified uptick rule might help restore investor confidence.

As set forth above, paragraphs (c) and (d) of proposed Rule 201 would permit a broker-dealer to mark a short sale order ''short exempt'' under certain circumstances.[191] Further, if an order is marked ''short exempt,'' proposed Rule 201(b)(1)(ii) provides that a trading center's policies and procedures must be reasonably designed to permit the execution or display of such order without regard to whether the order is at a down-bid price.[192] We have proposed these provisions to facilitate the proposed modified uptick rule's workability, while at the same time, not undermine our goals in proposing short sale price test restrictions.

We believe that permitting broker-dealers to mark ''short exempt'' short sale orders in connection with bona fide market making activity may undermine the goals of our proposed short sale price test restrictions at this time. In particular, we believe that for the proposed modified uptick rule to have the effect of helping to prevent declines in securities prices and restore investor confidence, provisions relating to when a broker-dealer may mark an order ''short exempt'' should be limited in scope.

In addition, we note that the proposed provision that would allow broker-dealers to mark short sale orders as ''short exempt'' in connection with riskless principal transactions would provide broker-dealers with flexibility to facilitate customer orders. A trading center's policies and procedures would also be designed to permit the execution or display of short sale orders at the offer. Additionally, in an advancing market, in accordance with proposed Rule 201(b)(1), a trading center's policies and procedures would be reasonably designed to permit the execution or display of short sale orders at the current national best bid and, therefore, in an advancing market, market makers could provide liquidity to the markets and meet purchasing demand.[193] For all these reasons, we do not believe it would be appropriate to provide that a broker-dealer may mark an order ''short exempt'' where the short

[187] 17 CFR 242.100(b).

[188] *See* Securities Exchange Act Release No. 11030 (Sept. 27, 1974), 39 FR 35570 (Oct. 2, 1974). Former Rule 10a–1(a)(1)(i) referenced the last sale price reported to an effective transaction reporting plan, but former Rule 10a–1(a)(2) also permitted an exchange to make an election to use the last sale price reported in that exchange market. Certain exchanges, such as the NYSE, implemented short sale price test rules consistent with former Rule 10a–1(a)(2). *See, e.g.,* former NYSE Rule 440B.

[189] *See id.*

[190] We note, however, that NASD's bid test contained an exception for short sales executed by qualified market makers in connection with bona fide market making. When, however, the Commission approved NASD's bid test and the market maker exception to the bid test it noted concerns that the market maker exception could create opportunities for abusive short selling. *See* 1994 NASD Bid Test Approval, 59 FR 34885. *See also supra* notes 125 and 136 (discussing NASD Rule 3350).

[191] *See* proposed Rule 201(c) and 201(d).

[192] *See* proposed Rule 201(b)(1)(ii).

[193] *See also* McCormick, D. Timothy and Zeigler, Bram, 1997, *The Nasdaq short sale rule: Analysis of market quality effects and the market maker exemption. Working paper, NASD Economic Research,* p. 28 (finding that market makers' short sales at the bid or below on down-bids amounted to only 1.17% of their trading).

sale order is in connection with bona fide market making activity.

We seek comment, however, on the importance of a market maker provision in the context of a market maker's role in providing liquidity, including the extent to which market makers would need to sell short at or below the current national best bid in their market making capacity. We also seek comment on the extent to which the proposed riskless principal provision, as well as any other proposed provisions, would address concerns regarding the need for a more general market maker provision. In addition, we seek comment regarding what conditions should apply if a general market maker provision were added to when a broker-dealer may mark an order ''short exempt'' under the proposed modified uptick rule. We also seek comment on whether a general market maker exception should be limited to registered market makers.

3. Proposed Modified Uptick Rule and After-Hours Trading

Regular trading hours in the U.S. are from 9:30 a.m. to 4 p.m. Eastern Time (''ET'').[194] A high volume of trading occurs, however, outside of these regular trading hours. Accordingly, the Commission interpreted former Rule 10a–1 to apply to all trades in covered securities, whenever they occurred.[195] By its terms, former Rule 10a–1 used as a reference point the last sale price reported to the consolidated tape. Thus, after the consolidated tape ceased to operate, the rule prevented any person from effecting a short sale in a listed security at a price lower than the last sale reported to the consolidated tape.[196] Although former Rule 10a–1 applied in the after-hours market, we do not believe that the proposed modified uptick rule should apply to covered securities during periods that the national best bid is not collected, calculated and disseminated.

As discussed above, market information for quotes in NMS stocks is disseminated pursuant to two different national market system plans, the CQ Plan, and Nasdaq UTP Plan.[197] Quotation information is made available pursuant to the CQ Plan between 9 a.m. and 6:30 p.m. ET, while one or more participants is open for trading. In addition, quotation information is made available pursuant to the CQ Plan during any other period in which any one or more participants wish to furnish quotation information to the Plan.[198] Quotation information is made available by the Nasdaq UTP Plan between 9:30 a.m. and 4 p.m. ET. The Nasdaq UTP Plan also collects, processes, and disseminates quotation information between 4 a.m. and 9:30 a.m. (ET), and after 4 p.m. when any participant is open for trading, until 8 p.m. ET.[199]

During the time periods in which these Plans do not operate, real-time quote information is not collected, calculated and disseminated. We do not believe that it would further the goals of short sale price test regulation to apply the proposed modified uptick rule when the national best bid is not being collected, calculated and disseminated on a real-time basis. Thus, the proposed modified uptick rule would only apply at times when quotation information and, therefore, the national best bid, is collected, processed, and disseminated pursuant to a national market system plan. Thus, proposed Rule 201(f) limits application of the proposed modified uptick rule to times when ''a national best bid for [an] NMS stock is calculated and disseminated on a current and continuing basis by a plan processor pursuant to an effective national market system plan.'' [200] However, we seek comment on these issues.

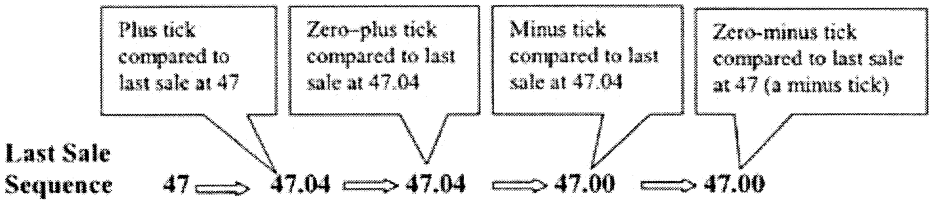
B. Proposed Uptick Rule

1. Operation of the Proposed Uptick Rule

As an alternative to proposing a short sale price test based on the national best bid, we are proposing a modified version of former Rule 10a–1 to provide the public with an opportunity to comment on the utility of such a price test, especially in light of the recent changes in market conditions.[201] The proposed uptick rule would use the last sale price as the reference point for short sale orders.

Specifically, the proposed uptick rule would provide that ''[n]o person shall, for his own account or for the account of any other person, effect a short sale of any covered security, if trades in such security are reported pursuant to an effective transaction reporting plan [202] and information as to such trades is made available in accordance with such plan on a real-time basis to vendors of market transaction information: (i) Below the price at which the last sale thereof, regular way, was reported pursuant to an effective transaction reporting plan; or (ii) At such price unless such price is above the next preceding different price at which a sale of such security, regular way, was reported pursuant to an effective transaction reporting plan.'' [203] Thus, under the proposed uptick rule, no short sale order may be effected below the last sale price. Short sale orders may be effected at the last sale price only if the last sale price is above the last different price. Otherwise, all short sale orders must be effected above the last sale price.

The following transactions illustrate the operation of the proposed uptick rule:



[194] *See, e.g.,* Rule 600(64) of Regulation NMS, defining the term ''regular trading hours.''

[195] *See* 2003 Regulation SHO Proposing Release, 68 FR at 62997 (stating that the Commission interprets former Rule 10a–1 to apply to all trades in listed securities whenever they occur).

[196] We note, however, that NASD did not extend its short sale price test rule to the after-hours market. *See* NASD Head Trader Alert #2000–55.

[197] *See supra* note 107. *See also* 17 CFR 242.603(b). Rule 603 of Regulation NMS requires that every national securities exchange on which an NMS stock is traded and national securities association shall act jointly pursuant to one or more effective national market system plans to disseminate consolidated information, including a national best bid and national best offer, on quotations for and transactions in NMS stocks.

[198] *See http://www.nyxdata.com/cta.*

[199] *See http://www.utpdata.com/docs/UTP_PlanAmendment.pdf.*

[200] *See* proposed Rule 201(e).

[201] *See supra* Section II, discussing the history of short sale price test regulation in the United States and changes in market conditions and resulting erosion of investor confidence.

[202] Proposed Rule 201(a)(3) provides that the term ''transaction reporting plan'' shall have the same meaning as in § 242.600(22) of Regulation NMS.

[203] Proposed Rule 201(b).

The first execution at 47.04 is a plus tick since it is higher than the previous last trade price of 47.00. The next transaction at 47.04 is a zero-plus tick since there is no change in trade price but the last change was a plus tick. Short sales could be executed at 47.04 or above in both of these cases. The final two transactions at 47.00 are minus and zero-minus transactions, respectively. Short sales in these two circumstances would have to be effected at a price above 47.00 in order to comply with proposed uptick rule.

Similar to the proposed modified uptick rule, the proposed uptick rule would apply to any ''covered security,'' which is defined as an ''NMS stock'' under Rule 600(a)(47) of Regulation NMS. Rule 600(a)(47) of Regulation NMS defines an ''NMS stock'' as ''any NMS security other than an option.'' [204] Rule 600(a)(46) of Regulation NMS defines an ''NMS security'' as ''any security or class of securities for which transaction reports are collected, processed, and made available pursuant to an effective transaction reporting plan, or an effective national market system plan for reporting transactions in listed options.'' [205] As a result, the proposed uptick rule would effectively cover all securities, other than options, listed on a national securities exchange whether traded on an exchange or in the OTC market. It would not include non-NMS stocks quoted on the OTC Bulletin Board or elsewhere in the OTC market.

We are not proposing to apply the proposed uptick rule to non-NMS stocks quoted on the OTC Bulletin Board or elsewhere in the OTC market because these securities were not subject to former Rule 10a–1. We recognize, however, that issuers of non-NMS stocks, which often are less actively traded securities than NMS stocks, may believe that they are particularly vulnerable to abusive short selling. Thus, we seek specific comment regarding whether the proposed uptick rule or some other form of price test should apply to these types of securities.

As discussed above in connection with the proposed modified uptick rule, the scope of securities covered by the proposed uptick rule would be similar to the scope of securities covered by former Rule 10a–1. Former Rule 10a–1(a) applied to securities registered on, or admitted to unlisted trading privileges on, a national securities exchange, if trades of the security were reported pursuant to an effective transaction reporting plan and information regarding such trades was made available in accordance with such plan on a real-time basis to vendors of market transaction information. All securities that would have been subject to former Rule 10a–1 would also be subject to the proposed uptick rule. In addition, certain securities, such as securities traded on Nasdaq, that were not subject to former Rule 10a–1, would be subject to the proposed uptick rule.[206]

As discussed in more detail above, the Commission eliminated former Rule 10a–1 and prohibited any SRO from having a price test in an effort in part to modernize and simplify short sale regulation in light of current trading systems and strategies used in the marketplace. In supporting its elimination of former Rule 10a–1, the Commission noted that the increased demand for exemptions from the Rule, and the disjointed application of short sale price tests had limited the reach of short sale price test restrictions, created confusion and compliance difficulties as well as an un-level playing field among market participants. In addition, the Commission noted that decimal increments had resulted in a rule that was no longer suited to the wide variety of trading strategies and systems used in the marketplace. The Commission also discussed that following its study of the effects of removing short sale price tests, OEA had found little empirical justification for maintaining former Rule 10a–1 and that, on balance, elimination of short sale price test restrictions for pilot stocks had not had a deleterious effect on market quality based on the examination of transactions during the period covered by the Pilot.[207]

Similar to the proposed modified uptick rule, the proposed uptick rule is designed to allow relatively unrestricted short selling in an advancing market. In addition, it is designed to restrict short selling at successively lower prices and, thereby, might help prevent short selling, including potentially abusive or manipulative short selling, from being used as a tool for driving the market down or from being used to accelerate a declining market by exhausting all remaining bids at one price level, causing successively lower prices to be established by long sellers. In addition, the proposed uptick rule, similar to the proposed modified uptick rule, would not result in the type of disparate short sale regulation that existed under former Rule 10a–1 because proposed Rule 201(d) would include a requirement that no SRO shall have any rule that is not in conformity with, or conflicts with, the short sale price test requirements of the proposed uptick rule. Another potential advantage to the proposed uptick rule is that market participants would be familiar with the test because it would be based on former Rule 10a–1 which was in existence for almost 70 years, and was only recently eliminated.

At the same time, some of the reasons cited by the Commission for eliminating former Rule 10a–1, which are unique to the proposed uptick rule as a price test based on the last sale price, remain today. For example, as discussed in more detail below, as a short sale price test that is based on the last sale price, the proposed uptick rule includes a number of exceptions necessary to accommodate the various trading strategies and systems used in today's marketplace. For example, the proposed uptick rule includes an exception for automated trading systems that utilize passive pricing and trading systems that offer price improvement based on the national best bid. The proposed uptick rule also includes an exception to allow market makers or specialists publishing two-sided quotes to sell short at the offer to facilitate customer market or marketable limit buy orders regardless of the last sale price.

In addition, as noted above in connection with our discussion of the proposed modified uptick rule, we believe the spread of more fully automated markets may make a test based on the last sale price less effective at regulating short selling than a test based on the national best bid due to delays in reporting of last sale price information and because last sale price information is published in reporting sequence and not trade sequence. Such trade reporting may create up-ticks and down-ticks that may not accurately

[204] 17 CFR 242.600(a)(47).

[205] 17 CFR 242.600(a)(46).

[206] *See supra* note 106. We note that former Rule 10a–1(b) applied the restrictions of former Rule 10a–1 to short sales on a national securities exchange in securities for which trades were not reported pursuant to an ''effective transaction reporting plan,'' as defined in Rule 600 of Regulation NMS, and for which information as to such trades was not made available in accordance with such plan on a real-time basis to vendors of market transaction information. Former Rule 10a–1(b) provided, in part: ''No person shall, for his own account or for the account of any other person, effect on a national securities exchange a short sale of any security not covered by paragraph (a) of this rule, 1. below the price at which the last sale thereof, regular way, was effected on such exchange, or 2. at such price unless such price is above the next preceding different price at which a sale of such security, regular way, was effected on such exchange.'' A similar provision would not be applicable to the proposed uptick rule because the proposed uptick rule applies to all NMS stocks, which, by definition, include only those stocks for which trades are collected, processed, and made available pursuant to an effective transaction reporting plan. *See* 17 CFR 242.600(b)(47) and (b)(46).

[207] *See* 2006 Price Test Elimination Proposing Release, 71 FR at 75073.

reflect price movements in the security for purposes of the proposed uptick rule. Because last trade prices can be reported out of sequence, for various reasons, we believe bids may be a more accurate reflection of current prices for a security.

Although former Rule 10a–1 was only recently eliminated, we recognize that due to the extensive systems changes that have occurred in the last couple of years in response to Regulation NMS, programming systems for the proposed uptick rule may be burdensome. For example, we note that at the same time that we proposed and subsequently adopted amendments to eliminate former Rule 10a–1, market participants were programming their systems to comply with Regulation NMS. It is our understanding that some market participants may not have included in their programming coding that would have allowed for the application of short sale price test restrictions at that time.[208]

Although the proposed uptick rule does not take a policies and procedures approach, it is likely that market participants would use a policies and procedures approach as part of their efforts to comply with the proposed prohibition. As such, for either proposed approach (prohibition or policies and procedures), market participants could consider whether to build off the policies and procedures they already have in place under Regulation NMS. As discussed above in connection with the proposed modified uptick rule, trading centers have been required to develop policies and procedures in accordance with Regulation NMS that would be similar to the types of policies and procedures that would be required under the proposed modified uptick rule.

The proposed uptick rule may be more burdensome to apply than the proposed modified uptick rule, however, because the prohibition approach of the proposed uptick rule would not allow any short sale at an impermissible price, even if in error or inadvertent, unless an exception applies. If the Commission were to decide to provide an exception for inadvertent errors, that could reduce the differences between the two proposed approaches. In addition, the proposed uptick rule could follow a policies and procedures approach similar to the approach discussed in connection with the proposed modified uptick rule. Such a policies and procedures approach would require that market participants continuously surveil for compliance and take prompt remedial steps to limit the execution or display of short sales at impermissible prices.

As discussed above, we are proposing a short sale price test based on the last sale price, and, in particular, we are proposing a modernized version of former Rule 10a–1 to provide the public with the opportunity to comment on this test in light of changes that have occurred in market conditions and investor confidence since the elimination of former Rule 10a–1 in mid-2007. Because we want to provide the public with the opportunity to comment on a short sale price test similar to former Rule 10a–1, we are not proposing a policies and procedures type of approach in connection with the proposed uptick rule because this would be a substantial change from how former Rule 10a–1 was applied. We note, however, that some commenters may believe that a policies and procedures approach similar to the approach discussed under the proposed modified uptick rule that references the last sale price, rather than the national best bid, might be preferable to either the proposed modified uptick rule or the proposed uptick rule. Thus, we seek specific comment regarding such an approach.

If we were to adopt the proposed uptick rule, we are proposing that there would be a three month implementation period such that market participants would have to comply with the proposed uptick rule three months following the effective date of the proposed uptick rule. We believe that a proposed implementation period of three months after the effective date would provide market participants with sufficient time in which to modify their systems and procedures in order to comply with the requirements of the proposed uptick rule. Among other things, we believe this period would be a reasonable period because market participants would be familiar with the changes to their trading systems necessary to implement the proposed uptick rule as the proposed uptick rule would be similar to former Rule 10a–1. The addition of an implementation period should help alleviate potential disruptive effects of the proposal.

We realize, however, that a shorter or longer implementation period may be manageable or preferable. Thus, we seek specific comment as to what length of implementation period would be necessary or appropriate, and why, such that market participants would be able to meet the proposed short sale price test restrictions, if adopted.

2. Exceptions to Proposed Uptick Rule

Paragraph (c) of Rule 201 of the proposed uptick rule sets forth exceptions to the proposed rule to promote its workability. Rule 201(c) of the proposed uptick rule would include exceptions that parallel provision set forth in proposed Rule 201(d) of the proposed modified uptick rule pursuant to which a broker-dealer may mark an order ''short exempt'' for purposes of that proposed rule. Thus, proposed Rule 201(c) of the proposed uptick rule would also include exceptions for: (i) A seller's delay in delivery as set forth in Section III.A.2.b above; (ii) odd lots, as set forth in Section III.A.2.c. above; (iii) domestic arbitrage, as set forth in Section III.A.2.d. above; (iv) international arbitrage, as set forth in Section III.A.2.e. above; (v) over-allotments and lay-off sales, as set forth in Section III.A.2.f. above; (vi) transactions on a VWAP basis, as set forth in Section III.A.2.h above; and (vii) riskless principal transactions as set forth in Section III.A.2.g. above. We believe that the rationale for these provisions under the proposed modified uptick rule would be equally applicable to the proposed uptick rule. Thus, we do not repeat the discussions of these provisions in connection with our discussion regarding the proposed uptick rule.

The following discussion sets forth the rationale regarding exceptions that would be unique to the proposed uptick rule. The exceptions contained in paragraph (c) of proposed Rule 201 are based upon exceptions contained in former Rule 10a–1 and exemptive relief granted pursuant to that rule. These exceptions and exemptions, as applicable, had been in place under former Rule 10a–1 for several years. We are not aware of any reason that the

[208] In connection with the elimination of former Rule 10a–1 and all short sale price test restrictions, we noted that commenters to the proposed amendments to eliminate all short sale price test restrictions discussed potential reprogramming costs that market participants may incur if the proposed amendments were not effective prior to the date for which all automated trading centers were required to have fully operational Regulation NMS-compliant trading systems, *i.e.,* July 9, 2007 (the ''Regulation NMS Compliance Date''). For example, we noted that the Securities Industry Financial Markets Assn. (''SIFMA'') urged the Commission to take steps to eliminate price test restrictions prior to the Regulation NMS Compliance Date to alleviate the need for firms to, in the course of instituting programming changes to meet the new requirements of Regulation NMS, program systems to comply with price test restrictions, only to be required to reverse such programming costs shortly thereafter. After considering these comments, we made the elimination of short sale price test restrictions immediately effective to provide market participants with sufficient notice and time prior to the Regulation NMS Compliance Date to reprogram their systems without regard to the then-current short sale price test restrictions. *See* 2007 Price Test Adopting Release, 72 FR at 36356, 36359.

rationales underlying these exceptions and exemptions would not still hold true today. Moreover, due to the limited scope of the proposed exceptions and exemptions, we do not believe that they would undermine the Commission's stated goals for proposing short sale price test restrictions.

Thus, the exceptions in proposed Rule 201(c) parallel exceptions to and exemptive relief granted under former Rule 10a–1. As set forth in more detail below, however, we seek comment regarding each of these exceptions, including whether or not these exceptions would be appropriate or necessary under the proposed modified uptick rule particularly in light of trading systems and strategies used in today's marketplace.

a. Error in Marking a Short Sale

Proposed Rule 201(c)(2) would provide an exception from the proposed uptick rule where a broker-dealer effects a sale order marked ''long'' by another broker-dealer, but the order was mis-marked such that it should have been marked as a ''short'' sale order. Specifically, proposed Rule 201(c)(2) provides that the proposed uptick rule shall not apply to ''[a]ny sale by a broker or dealer of a covered security for an account in which it has no interest, pursuant to an order marked long.'' [209]

The broker-dealer that marks the order ''long'' must comply with the order marking requirements of Rule 200(g) of Regulation SHO.[210] Subsection (e)(2) of former Rule 10a–1 contained an exception for mis-marked short sales. The exception was included in former Rule 10a–1 when the rule was adopted in 1938 and was provided to ''avoid implicating in any violation of the rules a member whose participation in the violation [was] unwitting and unintentional.'' [211] The exception in proposed Rule 201(c)(2) would avoid implicating the broker-dealer effecting the sale where the broker-dealer's participation in the violation was neither knowing nor reckless.[212]

b. Electronic Trading Systems

Proposed Rule 201(c)(8) would provide an exception from the proposed uptick rule for sales of securities in certain electronic trading systems that match and execute trades at various times and at independently-derived prices, such as at the mid-point of the NBBO. The Commission granted limited exemptive relief in connection with these systems under former Rule 10a–1 because matches could potentially occur at a price below the last sale price.[213] Similarly, under the proposed uptick rule, matches could potentially occur at a price below the last sale price and, therefore, violate the provisions of proposed Rule 201(b) prohibiting short sales on a minus or zero-minus tick, absent an exception.

This exception provides that the proposed uptick rule shall not apply to any sale of a covered security in an electronic trading system that matches buying and selling interest at various times throughout the day if: (1) Matches occur at an externally derived price within the existing market and above the current national best bid; (2) sellers and purchasers are not assured of receiving a matching order; (3) sellers and purchasers do not know when a match will occur; (4) persons relying on the exception are not represented in the primary market offer or otherwise influence the primary market bid or offer at the time of the transaction; (5) transactions in the electronic trading system are not made for the purpose of creating actual, or apparent, active trading in, or depressing or otherwise manipulating the price of, any security; (6) the covered security qualifies as an ''actively-traded security'' (as defined in Rules 101(c)(1) and 102(d)(1) of Regulation M), or where the subject listed security is not an ''actively-traded security,'' the proposed short sale transaction will be permitted only if it is conducted as part of a basket transaction of twenty or more securities in which the subject security does not comprise more than 5% of the value of the basket traded; and (7) during the period of time in which the electronic trading system may match buying and selling interest, there is no solicitation of customer orders, or any communication with customers that the match has not yet occurred.[214]

The conditions set forth in the exception in proposed Rule 201(c)(8) parallel the conditions provided in the exemptive relief granted under former Rule 10a–1. Consistent with the relief granted under former Rule 10a–1 and the rationales provided in granting such relief, we believe it is appropriate to propose an exception to the proposed uptick rule for short sales submitted to these electronic trading systems because such rationales still hold true today. In particular, we note that due to the passive nature of pricing and the lack of price discovery, trades executed through these systems generally would not involve the types of abuses that the proposed uptick rule would be designed to prevent.

c. Trade-Throughs

Proposed Rules 201(c)(10) and (11) would provide exceptions from the requirements of the proposed uptick rule that would help address any potential conflict between the proposed uptick rule and the Quote Rule under the Exchange Act.[215] These exceptions parallel the exceptions contained in former Rule 10a–1(e)(5)(ii) and (e)(11), respectively.

Former Rule 10a–1(e)(5)(ii) was added to former Rule 10a–1 to address a potential conflict between the operation of former Rule 10a–1 and the ''firm quote requirement'' of the Quote Rule [216] in situations where execution of an offer quotation by a broker-dealer would be rendered unlawful because of a trade-through,[217] even though the offer had been at a price permitted under former Rule 10a–1 at the time that the broker-dealer had communicated it to its exchange or association for inclusion in the consolidated quotation system.[218]

[209] Proposed Rule 201(c)(2).

[210] *See* 17 CFR 242.200(g).

[211] *See* Former Rule 10a–1 Adopting Release, 3 FR 213.

[212] Knowledge may be inferred where a broker-dealer has previously accepted orders marked ''long'' from the same counterparty that required borrowed shares for delivery or that resulted in a ''fail to deliver.'' *See* 2004 Regulation SHO Adopting Release, 69 FR at 48019, n.111 (stating that ''[i]t may be unreasonable for a broker-dealer to treat a sale as long where orders marked 'long' from the same customer repeatedly require borrowed shares for delivery or result in 'fails to deliver.' A broker-dealer also may not treat a sale as long if the broker-dealer knows or has reason to know that the customer borrowed shares being sold.'').

[213] *See e.g., supra* note 26.

[214] *See* Proposed Rule 201(c)(8).

[215] *See* 17 CFR 242.602.

[216] At the time the Commission adopted former Rule 10a–1(e)(5)(ii), the Quote Rule was included in Rule 11Ac1–1 under the Exchange Act. The Quote Rule is now in Rule 602 of Regulation NMS. *See* 17 CFR 242.602.

[217] A ''trade-through'' generally means the purchase or sale of a security at a price that is lower than a protected bid or higher than a protected offer. *See* 17 CFR 242.600(a)(77) (defining the term ''trade-through'' for purposes of Regulation NMS).

[218] The following example from the release adopting the exception illustrates the potential conflict: A market maker who currently has a short position in XYZ stock communicates an offer which, if executed against at that time, would be in compliance with Rule 10a–1, *e.g.*, at a price of 20⅛ when the last trade price reported in the consolidated system is also 20⅛. There is a ''trade through'' of the market maker's offer on another trading venue that causes an up-tick to be reported in the consolidated system at 20¼. Finally, a buy order is sent to the market maker after the trade through at 20¼ has been reported. In order to ensure compliance with 10a–1, the market maker must refuse to execute the order at his offer of 20⅛ because doing so would result in a short sale being effected on an impermissible minus tick, however, in refusing to effect the trade, he would arguably violate the ''firm quote requirement'' of the Quote Rule. In addition, when a market maker ''backs away'' from an order, he may, in effect be revealing that he had a short position in the security, thus

Continued

To resolve this potential conflict, the Commission adopted the exception in subsection (e)(5)(ii) of former Rule 10a–1 to permit market makers to execute transactions at their offer following a trade-through, and (e)(11) to permit non-market makers to effect a short sale at a price equal to the price associated with their most recently communicated offer up to the size of that offer [219] provided the offer was at a price, when communicated, that was permissible under former Rule 10a–1. The (e)(11) exception was added in response to several comments that, in addition to orders for their own account, specialists and other floor members also often represent as part of their displayed quotation orders of other market participants (*e.g.*, public agency orders or proprietary orders of non-market makers) that also might be ineligible for execution under former Rule 10a–1 following a trade-through in another market.[220]

We believe that the rationale for adopting the exceptions in former Rule 10a–1(e)(5)(ii) and (e)(11) and proposed in subsections (c)(10) and (c)(11) of the proposed uptick rule, namely resolving a conflict between a short sale price test based on the last sale price and the Quote Rule would exist under the proposed uptick rule. Thus, the proposed exceptions would parallel the exceptions in former Rule 10a–1(e)(5)(ii) and (e)(11).[221]

Specifically, proposed Rule 201(c)(10) would provide that the restrictions of the proposed uptick rule shall not apply to: ''[A]ny sale of a covered security (except a sale to a stabilizing bid complying with § 242.104 of Regulation M) by a registered specialist or registered exchange market maker for its own account on any exchange with which it is registered for such security, or by a third market maker for its own account over-the-counter, (i) Effected at a price equal to the most recent offer communicated for the security by such registered specialist, registered exchange market maker or third market maker to an exchange or a national securities association (''association'') pursuant to § 242.602 of this chapter, if such offer, when communicated, was equal to or above the last sale, regular way, reported for such security pursuant to an effective transaction reporting plan. *Provided*, *however*, (ii) That any self-regulatory organization, by rule, may prohibit its registered specialist and registered exchange market makers from availing themselves of the exemption afforded by this paragraph (c)(10) if that self-regulatory organization determines that such action is necessary or appropriate in its market in the public interest or for the protection of investors.'' [222]

We believe that the rationale for adopting former Rule 10a–1(e)(5)(ii) still holds true today and, therefore, we have incorporated the language of that exception into proposed Rule 201(c)(10). Consistent with former Rule 10a–1(e)(5)(ii), the proposed exception would include language that would permit SROs to prohibit registered specialists and registered exchange market makers from availing themselves of this exception. We note that under former Rule 10a–1, SROs such as the NYSE prohibited registered specialists and registered exchange market makers from availing themselves of this exception.[223] We believe it would be appropriate to continue to provide this option to SROs.

Proposed Rule 201(c)(11) would provide that the restrictions of the proposed uptick rule shall not apply to: ''[A]ny sale of a covered security (except a sale to a stabilizing bid complying with § 242.104 of this chapter) by any broker or dealer, for his own account or for the account of any other person, effected at a price equal to the most recent offer communicated by such broker or dealer to an exchange or association pursuant to § 242.602 of this chapter in an amount less than or equal to the quotation size associated with such offer, if such offer, when communicated, was: (i) Above the price at which the last sale, regular way, for such security was reported pursuant to an effective transaction reporting plan; or (ii) At such last sale price, if such last sale price is above the next preceding different price at which a sale of such security, regular way, was reported pursuant to an effective transaction reporting plan.'' We believe that the rationale for adopting former Rule 10a–1(e)(11) still holds true today and, therefore, we have incorporated the language of that exception into proposed Rule 201(c)(10).

d. Facilitation of Customer Buy Orders

Proposed Rule 201(c)(12) would provide for an exception from the proposed uptick rule for short sales by registered market makers or specialists publishing two-sided quotes to sell short at the offer to facilitate customer market and marketable buy limit orders regardless of the last sale price.[224] We believe that this exception would be necessary because some third market makers in exchange-listed securities offer trade execution for eligible customer orders at a price equal to or better than the national best offer. Under the proposed uptick rule, if the national best offer were below the previous last reported sale in a security and the third market maker or specialist has a short position, sales at the national best offer would violate the proposed uptick rule. The proposed exception would provide limited relief in a decimals environment to registered market makers and specialists so that they could provide liquidity in response to customer buy limit orders. Because this relief is limited to short selling only at the national best offer and only in response to customer buy limit orders we believe that it would not undermine the goals of short sale price test regulation, including helping to prevent short selling from being used as a tool to drive the market down.

3. Proposed Uptick Rule and After-Hours Trading

As discussed above in connection with the proposed modified uptick rule, the Commission interpreted former Rule 10a–1 to apply to all trades in covered securities, whenever they occurred. By its terms, former Rule 10a–1 used as a reference point the last sale price reported to the consolidated tape. Thus, after the consolidated tape ceased to operate, the rule prevented any person from effecting a short sale in a listed

making it more difficult to liquidate that position at favorable prices. *See* Securities Exchange Act Release No. 17314 (Nov. 20, 1980), 45 FR 79018 (Nov. 28, 1980).

[219] The Commission explained in the release that the scope of the exception in former Rule 10a–1(e)(11) was limited to the size of the broker-dealer's displayed offer because the need for the exception only arises to the extent that the broker-dealer's obligations under the Quote Rule may conflict with former Rule 10a–1. Because the firm quote requirement of the Quote Rule only applies to a broker-dealer's displayed offer, it was deemed appropriate to limit the exception to the size of the displayed offer. *See supra* note 218 at n.20.

[220] This concern was illustrated in the release adopting the amendments with the following example: A specialist who is short XYZ stock quotes an offer for 1,000 shares at 20⅛ at a time when the last sale reported in the consolidated system was such that the offer, if executed at that time, would be in compliance with Rule 10a–1. This offer for 1,000 shares consists of 300 shares offered by the specialist, a 400-share limit order in the specialist's book, and an offer from the crowd at the specialist's post for 300 shares, all at 20⅛. A trade through of this offer occurs on another exchange and an up-tick is reported in the consolidated system at 20¼. A buy order for 1,000 shares at 20⅛ is then sent to the exchange—after the trade through at 20¼ is reported. Without (e)(11), filling the complete order for 1,000 shares would not be permissible, since (e)(5)(ii), by its terms, applied only to a sale by a market maker for its own account. *See supra* note 218 at n.18.

[221] *See* Proposed Rule 201(c)(10) and (c)(11).

[222] *See* Proposed Rule 201(c)(10).

[223] *See* former NYSE Rule 440B.

[224] *See* proposed Rule 201(c)(12). This exception parallels exemptive relief provided by the Commission under former Rule 10a–1.

security at a price lower than the last sale reported to the consolidated tape.[225] Although former Rule 10a–1 applied in the after-hours market, similar to the proposed modified uptick rule, we do not believe that the proposed uptick rule should apply to covered securities while last sale price information is not collected, processed, and disseminated.[226]

As discussed above, last sale price information for NMS stocks is disseminated pursuant to a national market system plan, the CTA Plan.[227] The CTA Plan disseminates last sale price information during the hours in which any of its participants that regularly reports to the Plan is open for trading. In addition, the Plan disseminates last sale price information at other times during which any of its exchange participants is open for trading.[228] During times in which the CTA Plan does not collect, process, and disseminate last sale price information, real-time last sale price information is not available. For the same reasons discussed in connection with the proposed modified uptick rule, we do not believe that it would further the goals of short sale price test regulation to apply the proposed uptick rule when last sale price information is not being collected and disseminated on a real-time basis. Thus, proposed Rule 201(e) limits application of the proposed uptick rule to times when ''a last sale price for [an] NMS stock is collected and disseminated on a current and continuing basis by a plan processor pursuant to an effective national market system plan.'' [229]

C. The Proposed Circuit Breaker Rules

We also are proposing for comment, as an alternative to the proposed price test restrictions, circuit breaker rules. The proposed circuit breaker halt rule would, when triggered by a specified decline in the price of a particular security, temporarily prohibit any person from selling short a particular NMS stock during severe market declines in that security, subject to certain exceptions. The proposed circuit breaker modified uptick rule would, when triggered by a specified decline in the price of a particular security, temporarily impose the proposed modified uptick rule for that security.

As discussed above, questions persist about the reasons for the rapid speed of steep declines in the prices of securities. A short selling circuit breaker rule would be designed to target only those securities that experience rapid severe intraday declines and, therefore, might help to prevent short selling from being used to drive the price of a security down or to accelerate the decline in the price of those securities.

In line with the Commission's position that market impediments should be minimized, a short selling circuit breaker when applied might benefit the market as a narrowly tailored response to extraordinary circumstances.[230] Unlike the market wide circuit breakers that halt all trading, a short selling circuit breaker would apply only to those individual securities that are facing a severe intraday decline in share price. A short selling circuit breaker could be structured in a number of ways. We set forth below three forms of circuit breakers.

1. Background on Circuit Breakers

To protect investors and the markets, the Commission has approved proposals to restrict or halt trading if key market indexes fall by specified amounts. For example, the Commission approved such proposals from various exchanges (''SRO Circuit Breakers'') in response to the October 1987 market break. These measures were designed to permit brief, coordinated cross-market halts to provide opportunities during a severe market decline to re-establish equilibrium between buying and selling interests in an orderly fashion, and help to ensure that market participants have a reasonable opportunity to become aware of, and respond to, significant price movements.[231]

Currently, all stock exchanges and FINRA have rules or policies to implement coordinated circuit breaker halts.[232] The options markets also have rules applying circuit breakers.[233] The futures exchanges that trade index futures contracts have adopted circuit breaker halt procedures in conjunction with their price limit rules for index products.[234] Finally, security futures products are required to have cross-market circuit breaker regulatory halt procedures in place.[235] In addition, the Commission has authority under Section 12(k)(1) of the Exchange Act to suspend trading in the securities of individual issuers.[236] Moreover, SROs have rules or policies in place to coordinate individual security trading halts corresponding to significant news events.[237] Information on the securities subject to SRO regulatory trading halts is disseminated to market participants through the Common Messaging System (''CMS'') and other electronic media.[238]

The current SRO Circuit Breakers impose percentage based triggers that result in trading halts of varying lengths, dependent on the DJIA's rate of decline.[239] Unlike the original SRO

[225] We note, however, that NASD did not extend its short sale price test rule to the after-hours market. *See* NASD Head Trader Alert #2000–55.

[226] *See supra* Section III.A.2. (discussing our belief that the proposed modified uptick rule should not apply when the national best bid is not collected, processed, and disseminated on a real-time basis).

[227] *See* 17 CFR 242.603(b). Rule 603 of Regulation NMS requires that every national securities exchange on which an NMS stock is traded and national securities association shall act jointly pursuant to one or more effective national market system plans to disseminate consolidated information, including a national best bid and national best offer, on quotations for and transactions in NMS stocks.

[228] *See http://www.nyxdata.com/cta.*

[229] *See* proposed Rule 201(e).

[230] *See* Securities Exchange Act Release No. 39846 (Apr. 9, 1998), 63 FR 18477 (Apr. 15, 1998) (order approving proposals by Amex, BSE, CHX, NASD, NYSE, and Phlx) (''1998 Release'').

[231] *See* Securities Exchange Act Release No. 26198 (Oct. 19, 1988), 53 FR 41637 (Oct. 24, 1988) (approving rules of the Amex, CBOE, NASD, NYSE).

[232] *See* 1998 Release *supra* note 230. *See also* NYSE Rule 80B. The circuit breaker procedures call for cross-market trading halts when the Dow Jones Industrial Average (DJIA) declines by 10 percent, 20 percent, and 30 percent from the previous day's closing value. *See e.g.,* BATS Exchange Rule 11.18.

[233] *See* Amex Rule 950 (applying Amex Rule 117, Trading Halts Due to Extraordinary Market Volatility, to options transactions); CBOE Rule 6.3B; ISE Rule 703; NYSE Arca Options Rule 7.5; and Phlx Rule 133.

[234] *See, e.g.,* CME Rule 35102.I. The CME will implement a trading halt on S&P 500 Index futures contracts if a NYSE Rule 80B trading halt is imposed in the primary securities market. Trading of S&P 500 Index futures contracts will resume upon lifting of the NYSE Rule 80B trading halt.

[235] *See* Securities Exchange Act Release No. 45956 (May 17, 2002), 67 FR 36740 (May 24, 2002).

[236] *See* 15 U.S.C. 78*l*(k)(1).

[237] *See, e.g.,* FINRA Rule 6120.

[238] For example, in addition to disseminating news of trading halts through the CMS, Nasdaq publishes a daily list of securities subject to trading halts indicating the name of the issuer, the time the halt was initiated, and where applicable, the times at which quoting and trading may resume.

[239] *See* 1998 Release 63 FR 18477 *supra* note 230 and accompanying text (The SRO Circuit Breakers, as adopted in 1988, called for a one-hour trading halt if the DJIA declined by 250 points from the previous day's close, and a two-hour halt in the event of a 400 point decline.). *See* Securities Exchange Act Release No. 26198 (Oct. 19, 1988), 53 FR 41637 (Oct.24, 1988) (approving rules of the Amex, CBOE, NASD, NYSE). The original circuit breaker parameters were amended in 1996 to limit the duration of trading halts, and again in 1997 after it was determined that the 250 and 400 point thresholds were too low given the substantial increase in the value of the DJIA in the years following implementation of 1988 policies. The 1997 amendments increased the SRO Circuit Breakers' ''trigger values'' to 350 and 500 points respectively for the one-hour and two-hour trading halt scenarios. *See* Securities Exchange Act Release No. 38221 (Jan. 31, 1997) 62 FR 5871 (Feb. 7, 1997). The Commission approved the various Exchanges' circuit breaker revisions on a one year pilot basis. The SRO Circuit Breakers were revised again in 1998 to put into place circuit breakers triggered by certain percentage declines. *See* Securities

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Circuit Breakers, which used set point values to determine when a trading halt should be imposed, the current SRO Circuit Breakers are governed by percentage based declines tied to specific point values that are calculated at the beginning of each calendar quarter using the average daily DJIA closing for the previous month.[240]

Under the current SRO Circuit Breakers, a 10% decline prior to 2 p.m. will result in a one hour trading halt. Should the 10% decline occur after 2 p.m. but prior to 2:30 p.m., exchanges must halt trading for 30 minutes. If the 10% threshold is crossed after 2:30 p.m., trading will not be halted. A 20% decline in the DJIA will result in a two-hour trading halt, if the decline occurs prior to 1 p.m. and a one-hour trading halt if the threshold is reached between 1 p.m., and 2 p.m. If the DJIA declines by 20% after 2 p.m., under the current circuit breaker rules, trading will halt for the remainder of the day. Should the market decline by 30% at any point, trading will halt for the remainder of the day.[241] The coordinated cross-market trading halts provided by the SRO Circuit Breakers operate only during significant market declines and are intended to substitute orderly, pre-planned halts for the *ad hoc* and destabilizing halts which can occur when market liquidity is exhausted.[242]

The SRO Circuit Breakers focus on market indexes rather than on the market for an individual security. The SRO Circuit Breakers apply a market-wide trading halt, rather than a halt in an individual security, or a short selling halt. The proposed circuit breaker rules, in contrast, would temporarily restrict only short selling (and only) in an individual NMS security that suffers a severe price decline.

We believe that either a short sale price test restriction or a circuit breaker rule may be appropriate to address the recent change in market conditions and erosion of investor confidence. As discussed above, investors have become increasingly concerned about sudden and excessive declines in prices that appear to be unrelated to issuer fundamentals.[243] Circuit breakers that are triggered by severe declines in the price of individual securities may be a targeted response to address these concerns.

2. Proposed Circuit Breaker Halt Rule

We are proposing a short selling circuit breaker that, when triggered by a severe price decline in a particular security, would prohibit any person from selling short that security, wherever it is traded, while the circuit breaker is in effect, subject to certain exceptions.

While the Commission does not favor market closings as a general matter, the proposed circuit breaker halt rule would not be as broad as a market-wide trading halt. Furthermore, the Commission has recognized that circumstances may infrequently call for a trading pause that allows participants to reassess conditions.[244] We believe that a pause in short selling resulting from a significant decline in the price of an individual equity security might provide a similar measure of stability.

We seek comment on whether it would be appropriate for the Commission to impose a circuit breaker that when triggered would halt all short selling in an individual equity security, wherever it is traded, for the remainder of the trading day if the price of the security has declined by at least 10% from the prior day's closing price for that security, as measured by the closing price of the security on the consolidated system. Like the proposed modified uptick rule and the proposed uptick rule, we propose that it would apply to all NMS stocks as that term is defined under Rule 600(a)(47) of Regulation NMS.[245] We seek comment regarding the scope of a potential circuit breaker's application and to which securities it might most appropriately apply.

We preliminarily believe that a 10% decline in a security's price as measured from the prior day's closing price, as reported in the consolidated system, would be an appropriate level at which to trigger a circuit breaker that results in a short selling halt. As discussed above, such a percentage decline would be consistent with the current SRO Circuit Breakers.[246] The 10% threshold for a circuit breaker that, when triggered, results in a short selling halt in an individual security would reflect the format of current SRO Circuit Breakers and use a trigger based on a fluctuating value, the share price, to strike a balance between the need to halt short selling in moments of severe decline in a security's price and the market participant's expectation that its short selling strategy will be available in an efficient and open marketplace. We note that a group of national securities exchanges recommended a 10% decline threshold in connection with a short selling circuit breaker combined with a short sale price test restriction.[247] Another commenter supported a 10% minimum threshold, but also recommended a ''rolling'' circuit breaker that when triggered would impose short selling halts of varying lengths, depending on the level of decline in the price of an individual equity security.[248] We recognize that a lesser or greater percentage decline or some other measure of decline may be appropriate, and seek comment on that question.

As described in more detail below, the price decline would be based on the security's price during the trading day as reported in the consolidated system as compared to the prior day's closing price as reported in the consolidated system. The prior day's closing price would be the last price reported during regular trading hours[249] the prior day.

The proposed circuit breaker halt rule would, once triggered by a 10% decline in the price of a security from the prior day's closing price on any trading day, impose a short selling halt in the individual security at times when the last sale price is calculated and disseminated in the consolidated system. We based the time period on the calculation and dissemination of last sale price because the circuit breaker is triggered by a percentage decline in the security's intra-day last sale price relative to the prior day's last sale price at the end of regular trading hours on the prior day.

In addition, to avoid market disruption that may occur if a circuit breaker is triggered late in the trading day, the proposed circuit breaker rules would not be triggered if the specified market decline threshold is reached in an NMS security within thirty minutes of the end of regular trading hours. Former NYSE Rules 80A(a) and 80A(b) provided that a circuit breaker would not trigger program trading restrictions after 3:25 p.m., or approximately thirty-five minutes before the close. We seek comment as to whether thirty minutes is an appropriate balance to ensure that

Exchange Act Release No. 39846 (Apr. 9, 1998) 63 FR 18477 (Apr. 15, 1998).

[240] *See id.*

[241] *See* 1998 Release, 63 FR 18477 *supra* note 230.

[242] *See* Circuit Breaker Report by the Staff of the President's Working Group on Financial Markets (Aug. 18, 1998) (Circuit Breaker Report), n. 33.

[243] *See supra* Section II.C. (discussing investor confidence).

[244] *See* 1998 Release, 63 FR 18477 *supra* note 230.

[245] *See* proposed Rule 201(a)(1).

[246] *See* 1998 Release, 63 FR 18477 *supra* note 230 and accompanying text.

[247] *See* National Exchanges letter, *supra* note 63.

[248] *See* letter from Credit Suisse, *supra* note 122.

[249] ''Regular trading hours'' has the same meaning as in Rule 600(b)(64) of Regulation NMS. Rule 600(b)(64) provides that ''*Regular trading hours* means the time between 9:30 a.m. and 4 p.m. Eastern Time, or such other time as is set forth in the procedures established pursuant to § 242.605(a)(2).''

the goals of the proposed rule would be met while also reducing the potential for market disruption toward the close of regular trading hours.

We believe that a short selling halt that persists at times when the last sale price is calculated and disseminated following a 10% decline in a security's price might be appropriate. We are concerned that a short selling halt for a lesser time might not provide sufficient time to re-establish equilibrium between buying and selling interest in the individual security in an orderly fashion. We also believe that a short selling halt for this length of time might be necessary to help ensure that market participants have a reasonable opportunity to become aware of, and respond to, a significant decline in a security's price. We seek comment below, however, regarding whether a longer or shorter short selling halt would be appropriate, or whether it would be appropriate to impose a short selling halt on a rolling basis as suggested by an industry commenter.[250]

We are also seeking comment on the potential costs and benefits of a short selling circuit breaker that when triggered results in a temporary halt on short selling. The Commission has previously noted that circuit breakers may benefit the market by allowing participants an opportunity to reevaluate circumstances and respond to volatility.[251] Unlike the proposed modified uptick rule and the proposed uptick rule, this proposed circuit breaker halt rule would halt all short selling for an individual security for the specified period of time. In discussing a short selling circuit breaker, one commenter noted that such a measure could address the issue of ''bear raids'' while limiting the market impact that may arise from other forms of short sale price test restrictions.[252] The Commission has long held the view that coordinated circuit breakers might restore investor confidence during times of substantial uncertainty.[253] We believe the proposed circuit breaker halt rule might produce similar benefits.

We recognize, however, that there are potential costs associated with implementation of a short selling circuit breaker that when triggered results in a temporary short selling halt. As discussed below, we anticipate that market participants charged with implementation of such a short selling circuit breaker would have to invest human and financial resources to update systems as necessary for compliance. Furthermore, as discussed above, short selling is an important tool in price discovery and the provision of liquidity to the market, and we recognize that imposition of a short selling circuit breaker that when triggered imposes short selling halts could restrict otherwise legitimate short selling activity during periods of extreme volatility.

We also understand there are concerns about a potential ''magnet effect'' that could arise as an unintended consequence of a circuit breaker that halts short selling and results in short sellers driving down the price of an equity security in a rush to execute short sales before the circuit breaker is triggered. One commenter noted that a short sale circuit breaker could exacerbate downward pressure on stocks as their value reached the threshold level.[254] Another commenter, however, in discussing the issue of a ''magnet effect'' cited empirical studies that question whether a circuit breaker would result in artificial pressure on the price of individual securities.[255] We are also concerned about another type of ''magnet effect'' in which short selling demand is built up until the circuit breaker is lifted.

Similar to the short sale price test restrictions, the proposed circuit breaker halt rule would apply to NMS securities other than options. However, we seek comment below on whether such a rule should also apply to non-NMS securities.

The proposed circuit breaker halt rule would include exceptions substantially identical to exceptions that were included in the Short Sale Ban Emergency Order,[256] as amended by the Commission on September 21, 2008 (''September 21, 2008 Amended Order'') (collectively, the ''Short Sale Ban'').[257] We believe the proposed circuit breaker halt rule should include exceptions that mirror certain of the exceptions in the Short Sale Ban because the proposed rule shares the same goal of prohibiting short selling that might exacerbate a price decline during a period of sudden and excessive price declines, while being designed to maintain functions that, for example, would be necessary to help provide adequate liquidity. Short sales effected under these exceptions would be marked ''short exempt.''

The proposed circuit breaker halt rule could operate in place of, or in addition to, a short sale price test restriction. For instance, in addition to the imposition of a permanent, market-wide price test restriction, a circuit breaker halt rule could also prohibit any person from selling short any security that suffers a severe price decline.

a. Market Makers and Options Market Makers Engaged in Bona Fide Market Making Activities

The Short Sale Ban excepted registered market makers, block positioners, or other market makers obligated to quote in the over-the-counter market, if they were selling short a publicly traded security covered by the Short Sale Ban as part of bona fide market making in such security.[258] The purpose of the exception was to permit market makers to continue to provide liquidity to the markets, facilitate orders including customer buy orders, and otherwise comply with their obligations as market makers.

The term ''market maker'' includes any specialist permitted to act as a dealer, any dealer acting in the capacity of a block positioner, and any dealer who, with respect to a security, holds itself out (by entering quotations in an inter-dealer quotation system or otherwise) as being willing to buy and sell such security for its own account on a regular or continuous basis.[259] As the Commission has stated previously, a market maker engaged in bona fide market making is a ''broker-dealer that deals on a regular basis with other broker-dealers, actively buying and selling the subject security as well as regularly and continuously placing quotations in a quotation medium on both the bid and ask side of the market.''[260] We recently provided guidance on bona fide market making for purposes of Regulation SHO Rule 203(b), and believe that such guidance would also be appropriate with regard to a market maker exception for the proposed circuit breaker halt rule.[261] We believe it is appropriate to include a market maker exception for this proposed alternative because a halt in short selling in a security would, during the period of the halt, have far greater effects on liquidity and legitimate price discovery activity than the proposed modified uptick rule or proposed uptick

[250] *See* letter from Credit Suisse *supra* note 122.

[251] *See* 1998 Release, 63 FR 18477.

[252] *See* Brown Letter *supra* note 55.

[253] *See* 1998 Release, 63 FR 18477 *supra* note 230.

[254] *See* letter to Mary Schapiro, Chairman, from Direct Edge, dated March 30, 2009.

[255] *See* letter from Credit Suisse *supra* note 122.

[256] *See* Short Sale Ban Emergency Order, 73 FR 55169–02 (Sept. 24, 2008).

[257] *See* September 21, 2008 Amendment, 73 FR 55556–01 (Sept. 25, 2008).

[258] *See id.*

[259] *See* 2004 Regulation SHO Adopting Release, 69 FR at 48015, n. 66 (citing to Section 3(a)(38) of the Exchange Act).

[260] *See* Exchange Act Release No. 32632 (July 14, 1993), 58 FR 39072, 39074 (July 21, 1993).

[261] *See* Exchange Act Release No. 58775 (Oct. 14, 2008); 73 FR 61690 (Oct. 17, 2008).

rule, which, as discussed above, are each based on a trading unit increment.

b. Bona Fide Market Making in Derivatives

The Short Sale Ban also included an exception for any person that is a market maker that effects a short sale as part of bona fide market making and hedging activity related directly to bona fide market making in derivatives on the publicly traded securities of any security covered by the Short Sale Ban.[262] Under the Short Sale Ban, this exception applied to all market makers, including over-the-counter market makers, and to bona fide market making and hedging activity related directly to bona fide market making in exchange traded funds and exchange traded notes of which securities included in the Short Sale Ban were a component. We stated that the purpose of the exception was to permit market makers to continue to provide liquidity to the markets.[263] Similarly, we believe such an exception would be appropriate for the proposed circuit breaker halt rule.

During the period that the Short Sale Ban was effective, to help ensure that the exception would not result in increased short exposure in securities covered by the Short Sale Ban, we limited the exception so that if a customer or counterparty position in a derivative security based on the security was established after the effectiveness of the September 21 Amended Order, a market maker could not effect the short sale if the market maker knew that the customer's or counterparty's transaction would result in the customer or counterparty establishing or increasing an economic net short position (*i.e.,* through actual positions, derivatives, or otherwise) in the issued share capital of a firm covered by the Short Sale Ban. This provision was included to address potential circumvention of the Short Sale Ban during the several weeks that it was in effect.[264] However, we do not believe such a provision is necessary for the proposed circuit breaker halt rule because the rule as proposed only contemplates a one-day (or less than one day depending on when during the day the circuit breaker is triggered) prohibition on short selling of any NMS security that becomes subject to the circuit breaker.

c. Options and Futures Contract Expiration

The Short Sale Ban included an exception to allow short sales that occurred as a result of automatic exercise or assignment of an equity option held prior to effectiveness of the Short Sale Ban due to expiration of the option.[265] It also allowed short sales that occurred as a result of the expiration of futures contracts held prior to effectiveness of the Short Sale Ban.[266]

We propose including a similar exception for the proposed circuit breaker halt rule for short sales that occur as a result of automatic exercise or assignment of an equity option held before a circuit breaker on a particular security is triggered and a short selling halt is imposed in that security due to expiration of the option. We are also proposing an exception to the proposed circuit breaker halt rule to allow short sales that occur as a result of the expiration of futures contracts held before a circuit breaker is triggered in a particular security.

Persons that purchased or sold options prior to the effectiveness of a circuit breaker halt entered into such transactions with the expectation that they would be able to fulfill their contractual obligations and receive the benefits of their bargain in return. Generally, options contracts are purchased or sold prior to the day in which a circuit breaker might be triggered. Therefore, providing an exception to the proposed circuit breaker halt rule to allow such persons to continue to rely on their pre-existing transactions until completion does not raise the concerns that the proposed circuit breaker halt rule is intended to address. As with the Short Sale Ban, we propose to limit this exception to automatic exercises and assignments to prevent it from being abused by more discretionary options exercises.

d. Exception for Assignment To Call Writers Upon Exercise of an Option

To allow for creation of long call options, the Short Sale Ban included an exception to permit short sales that occur as a result of assignment to call writers upon exercise.[267] When options are exercised, call writers may be required to sell short in order to satisfy their obligations. Because call writers do not have discretion, and because the short sales are effected in order to fill buying demand, we believe that including this exception in the proposed circuit breaker halt rule would benefit the markets while not opening the door to the abuses that the proposed rule is intended to address.

e. Owned Securities

The Short Sale Ban provided that sales of Rule 144 securities were excepted from its requirements because Rule 144 securities are owned securities and do not raise the concerns that the Short Sale Ban was designed to address.[268] We believe a similar exception for securities that a seller is deemed to own under Rule 200(b) should be included in the proposal.

Rule 200(g)(1) of Regulation SHO provides that a sale can be marked ''long'' only if the seller is deemed to own the security being sold and either (i) the security is in the broker-dealer's physical possession or control, or (ii) it is reasonably expected that the security will be in the broker-dealer's physical possession or control by settlement of the transaction.[269] Thus, even where a seller owns a security, if delivery will be delayed, such as in the sale of formerly restricted securities pursuant to Rule 144 of the Securities Act of 1933, or where a convertible security, option, or warrant has been tendered for conversion or exchange, but the underlying security is not reasonably expected to be received by settlement date, such sales must be marked ''short.''[270] As a result, during a halt triggered by a circuit breaker, sellers would be permitted to sell securities that although owned, are subject to the provisions of Regulation SHO governing short sales due solely to the seller being unable to deliver the security to its broker-dealer prior to settlement based on circumstances outside the seller's control.

Although the Short Sale Ban only excepted Rule 144 securities, we believe that other securities considered ''deemed to own'' for purposes of Rule 200(b) should also be excepted from the proposed circuit breaker halt rule because these are owned securities that do not raise the same concerns that the proposed rule is designed to address.

3. Proposed Circuit Breaker Price Test Rules

We are also proposing a short selling circuit breaker that, when triggered by a severe decline in the price of a particular security, would impose short sale price restrictions for that security

[262] *See* Short Sale Ban Emergency Order, 73 FR 55169–02.

[263] *See id.*

[264] *See* September 21, 2008 Amendment, 73 FR 55556–01.

[265] *See* Short Sale Ban Emergency Order, 73 FR 55169–02.

[266] *See id.*

[267] *See* September 21, 2008 Amendment, 73 FR 55556–01.

[268] *See id.*

[269] *See* 17 CFR 242.200(g)(1).

[270] *See id.*

wherever it is traded for the remainder of the trading day. Such a circuit breaker would be imposed in place of a permanent, market-wide short sale price test restriction.

Similar to the reasons stated in the discussion above regarding the proposed circuit breaker halt rule, a circuit breaker price test rule would be triggered by a 10% intraday decline in the price of an individual equity security from the prior day's closing price as reported in the consolidated system. We preliminarily believe that a 10% decline in a security's price as measured from the prior day's closing price, as reported in the consolidated system, would be an appropriate level at which to trigger a circuit breaker that results in a short sale price test restriction. As discussed above, such a percentage decline would be consistent with the current SRO Circuit Breakers.[271] We recognize that a lesser or greater percentage decline or some other measure of decline may be appropriate.

We also seek comment regarding the form of the short sale price test restrictions that could be imposed when the proposed circuit breaker is triggered. Such a circuit breaker when triggered could impose a short sale price test restriction in the form of the proposed modified uptick rule based on the national best bid, or in the form of the proposed uptick rule based on the last sale price of the individual security. This would include the same proposed short sale price test and provisions that would be used in the proposed modified uptick and proposed uptick rules, permitting certain sales to occur notwithstanding the price limitations otherwise applicable under the two proposed rules.[272] We believe these provisions would be justified for the same reasons described regarding the proposed modified uptick rule and the proposed uptick rule, respectively.[273]

As described in more detail below, the price decline would be based on the security's price during the trading day as reported in the consolidated system as compared to the prior day's closing price as reported in the consolidated system. The prior day's closing price would be the last price reported during regular trading hours[274] the prior day.

The proposed circuit breaker modified uptick rule would, once triggered by a 10% decline in the price of a security from the prior day's closing price, impose the modified uptick rule in the individual security at times when the national best bid is calculated and disseminated in the consolidated system, for the remainder of the trading day. We based the time period on the calculation and dissemination of the national best bid in the consolidated system because the proposed modified uptick rule is based on the national best bid as calculated and disseminated in the consolidated system.

Similarly, the proposed circuit breaker uptick rule would, once triggered by a 10% decline in the price of a security from the prior day's closing price on any trading day, impose the uptick rule in the individual security at times when the last sale price is calculated and disseminated in the consolidated system. We based the time period on the calculation and dissemination of the last sale price because the proposed uptick rule is based on the last sale price as calculated and disseminated in the consolidated system.

To avoid market disruption that may occur if a circuit breaker is triggered late in the trading day, the proposed circuit breaker rules would not be triggered if the specified market decline threshold is reached in an NMS security within thirty minutes of the end of regular trading hours. Former NYSE Rules 80A(a) and 80A(b) provided that a circuit breaker would not trigger program trading restrictions after 3:25 p.m., or approximately thirty-five minutes before the close of regular trading hours. As with the proposed circuit breaker halt rule, we seek comment as to whether thirty minutes is an appropriate balance to ensure that the goals of the proposed rule would be met while also reducing the potential for market disruption toward the close of regular trading hours.

We believe that the temporary imposition of the proposed modified uptick rule, after a circuit breaker is triggered, that operates at times when the national best bid is disseminated following a 10% decline in a security's price might be appropriate. Similarly, we believe that the temporary imposition of the proposed uptick rule, after a circuit breaker is triggered, that operates at times when the last sale price is calculated and disseminated following a 10% decline in a security's price might be appropriate. We seek comment below, however, regarding whether longer or shorter time periods would be appropriate.

We are seeking comment on the potential benefits and costs of the proposed circuit breaker price test rule. We believe that such a rule might be a narrowly tailored means to help restore investor confidence and stabilize the market for individual securities. Such a rule might also help prevent short selling, including potentially abusive or manipulative short selling, from being used as a tool for driving the market down or from being used to accelerate a declining market by exhausting all remaining bids at one price level, causing successively lower prices to be established by long sellers. Further, we note that allowing short selling to continue with price test restrictions once the circuit breaker is triggered might have a lesser impact on legitimate short selling and normal market activity including price discovery and the provision of liquidity than a circuit breaker that triggers a short selling halt. We also believe that a circuit breaker rule that triggers a price test restriction, because it is based on a trading increment of a penny as opposed to a short sale halt, may also alleviate some concerns over the possibility of artificial downward pressure that might arise from a ''magnet effect'' prior to reaching the trigger threshold.

We recognize that a short selling circuit breaker that, when triggered, imposes short sale price test restrictions for the remainder of the trading day, would result in costs on market participants responsible for implementing and assuring compliance with the requirements of such restrictions. There might be significant operational costs associated with reprogramming systems to comply with short sale price test restrictions, and we anticipate that these costs might be greater than those required to comply with a short selling circuit breaker that, when triggered, imposes halts on short selling in individual securities. There might also be requirements for additional staff and costs associated with personnel hiring and training related to maintaining and ensuring compliance with any short sale price test restrictions.[275]

Further, we recognize that short sale price test restrictions imposed as a result of a circuit breaker might result in many of the same costs discussed in detail in Section IX pertaining to the implementation of market-wide short

[271] *See* 1998 Release, 63 FR 18477 *supra* note 230 and accompanying text.

[272] *See* Section III.A. and III.B. (discussing the operation of the proposed modified uptick rule and the proposed uptick rule respectively).

[273] *See* Sections III.A.2. and III.B.2. (discussing the short exempt provisions of the proposed modified uptick rule and proposed uptick rule, respectively).

[274] ''Regular trading hours'' has the same meaning as in Rule 600(b)(64) of Regulation NMS. Rule 600(b)(64) provides that ''*Regular trading hours* means the time between 9:30 a.m. and 4 p.m. Eastern Time, or such other time as is set forth in the procedures established pursuant to § 242.605(a)(2).''

[275] *See, e.g.,* Credit Suisse letter, *supra* note 122.

sale price test restrictions.[276] Those costs might include a reduction of the benefit of legitimate short selling and a subsequent reduction in the quantity of short selling, which we have noted might lead to a decrease in market quality and price discovery, less protection against upward stock price manipulations, a less efficient allocation of capital, an increase in trading costs, and a decrease in liquidity.[277] We are seeking comment on the extent of these and other costs associated with a circuit breaker that when triggered imposes short sale price test restrictions.

The proposed circuit breaker price test rule would result in either the proposed modified uptick rule or the proposed uptick rule, for the remainder of the trading day, as each proposed rule is described above. For instance, a circuit breaker resulting in the proposed modified uptick rule would require that trading centers establish, maintain, and enforce policies and procedures reasonably designed to prevent short selling on a downbid in a security where the circuit breaker has been triggered by a severe decline in the price of that NMS security. Broker-dealers could mark certain short sale orders ''short-exempt'' under the conditions set forth above. A circuit breaker that resulted in the proposed uptick rule would, when triggered by a decline in the price of a particular security, prohibit any person from selling short that security on a downtick. This would be a more limited approach than a short sale price test rule that is in place at all times and thus might result in fewer of the potential disadvantages that would result from a short sale price test that was in place at all times.

Under the proposed circuit breaker price test rule, a price test would not be in place on a permanent and market-wide basis for all securities. Under the proposed circuit breaker that results in the proposed modified uptick rule, trading centers would need to establish and maintain reasonable policies and procedures in advance so that they are able to comply with the proposed circuit breaker rule whenever triggered. It would not be reasonable for a trading center to wait until the circuit breaker is triggered to begin establishing policies and procedures to prevent the execution or display of the particular security on a downbid. Thus, a circuit breaker that triggers the proposed modified uptick rule would result in some immediate upfront costs to trading centers.

In the Solicitation of Comments, we seek comment on whether the short sale price test restrictions should remain in place for a longer or shorter period of time, whether a 10% decline would be an appropriate trigger for the circuit breaker proposals, or if for example, a 5% or 20% threshold might be more appropriate, and what additional costs may be associated with a proposed circuit breaker price test rule.

IV. Request for Comment

In addition to the specific requests for comment found throughout this proposing release, we seek comment generally from all members of the public on all aspects of the proposed amendments to Rules 200(g) and 201 of Regulation SHO. We request that commenters provide empirical data to support their views and arguments related to these proposals. In addition to the questions set forth above, commenters are welcome to offer their views on any other matter raised by the proposed amendments to Regulation SHO. Specifically, are there any other possible restrictions on short selling that the Commission should consider, particularly ones that might be helpful in a severe market decline?

Questions Regarding Proposed Short Sale Price Tests Generally

1. Should short sales be subject to a short sale price test restriction, or should we continue to rely on current short sale regulations and anti-fraud and anti-manipulation provisions of the securities laws to address potentially abusive short selling?

2. We note that our decision to propose a short sale price test was based, in part, on the recent changes in market conditions and investor confidence.[278] To what extent, if any, would a short sale price test, such as the proposed modified uptick rule or the proposed uptick rule, be necessary or appropriate in light of recent changes in market conditions? Please explain and provide empirical data in support of any arguments and/or analyses. How would the proposed modified uptick rule or the proposed uptick rule affect market conditions today? Please explain and provide empirical data in support of any arguments and/or analyses.

3. How effective would the proposed modified uptick rule or the proposed uptick rule be in allowing relatively unrestricted short selling in an advancing market? Please explain and provide empirical data in support of any arguments and/or analyses. How effective would the proposed modified uptick rule or proposed uptick rule be at helping to prevent short selling, including potentially abusive or manipulative short selling, from being used as a tool for driving the market down or from being used to accelerate a declining market by exhausting all remaining bids at one price level, causing successively lower prices to be established by long sellers? Please explain and provide empirical data in support of any arguments and/or analyses. Could the proposed modified uptick rule or proposed uptick rule be modified to better meet these goals? If so, how? Please explain and provide empirical data in support of any arguments and/or analyses.

4. We also note our concern regarding investor confidence based on the numerous requests for reinstatement of short sale price test restrictions.[279] Would reinstating a short sale price test restriction such as the proposed modified uptick rule or proposed uptick rule help restore investor confidence? If so, why? If not, why not? Please explain and provide empirical data or other specific information in support of any arguments and/or analyses.

5. In addition to investor confidence and market volatility, we have stated that we are concerned about potentially abusive short selling. Would the proposed modified uptick rule or proposed uptick rule help address potentially abusive short selling? If so, how? If not, why not? Please explain and provide empirical data in support of any arguments and/or analyses.

6. We note that short selling provides the market with important benefits, including market liquidity and pricing efficiency.[280] What effect, if any, would the proposed modified uptick rule or proposed uptick rule have on market liquidity? Please explain and provide empirical data in support of any arguments and/or analyses. What effect, if any, would the proposed modified uptick rule or proposed uptick rule have on pricing efficiency? Please provide empirical data in support of any arguments and/or analyses.

7. We also note that short selling may be used to illegally manipulate stock prices.[281] What impact, if any, would the proposed modified uptick rule or proposed uptick rule have on ''bear raids''? Please explain and provide empirical data in support of any arguments and/or analyses. To what extent, if any, does unrestricted short

[276] *See* Section IX (discussing costs and benefits of the proposed modified uptick rule and the proposed uptick rule).

[277] *See* Section IX.B.

[278] *See* Section II.C.

[279] *See id.*

[280] *See* Section II.A.

[281] *See id.*

selling exacerbate a declining market? Please explain and provide empirical data in support of any arguments and/or analyses.

8. Is there a need for short sale price test restrictions? If there is a need for a short sale price test, would the proposed modified uptick rule be the best test? If so, why? If not, why not? Would the proposed uptick rule be the best test? If so, why? If not, why not? What are the costs and benefits of the proposed modified uptick rule versus the proposed uptick rule? What would be the general costs and benefits of short sales being subject to the proposed modified uptick rule? What would be the general costs and benefits of short sales being subject to the proposed uptick rule? Should we consider other forms of short sale price tests? If so, what forms? What would be the costs and benefits of any alternative forms of short sale price tests? Please explain and provide empirical data in support of any arguments and/or analyses.

9. Would the proposed modified uptick rule or proposed uptick rule be an appropriate short sale price test in the current decimals environment? Would the proposed modified uptick rule or proposed uptick rule be more suitable in a decimals environment with multiple trading centers? Please explain and provide empirical data in support of any arguments and/or analyses.

10. Should the proposed modified uptick rule or proposed uptick rule be limited to specific sectors or industries, such as financials, due to the unique harms or susceptibility to harms to those industries or sectors from the potential adverse effect of short selling in a declining market? If so, please describe the types of industries or sectors that should be covered and the unique harms or susceptibility to harm to which they are subject. Please also describe the mechanisms or criteria that should be used to determine which entities fall within these industries or sectors.

11. One of the reasons for the elimination of former Rule 10a–1 and the prohibition on any SRO from having a short sale price test in July 2007 was because the application of short sale price tests had become disjointed with different price tests applying to the same securities trading in different markets. Under both proposed rules, all covered securities, wherever traded, would be subject to one short sale price test. What are the advantages or disadvantages of having a uniform short sale price test in the covered securities across all markets? Please explain.

12. How would trading systems and strategies used in today's marketplace be impacted by the proposed modified uptick rule or proposed uptick rule? How might market participants alter their trading systems and strategies in response to either proposed rule, if adopted? To further the goal of having a uniform short sale price test, both the proposed modified uptick rule and proposed uptick rule would provide that no SRO shall have any rule that is not in conformity with, or conflicts with either proposed rule. Is this prohibition necessary or appropriate? Would there ever be a need for an SRO to institute its own short sale price test? If so, why?

13. One of the reasons for the elimination of former Rule 10a–1 was that the disjointed application of the rule resulted in an un-level playing field among market participants. Could implementation of a short sale price test through a policies and procedures approach applicable to a ''trading center'' lead to disproportionate burden among market participants? In what way? Would a straight prohibition implementation approach be preferable in this regard? To what extent could the proposed exceptions to either alternative rule contribute to a disproportionate burden on certain market participants? What effect might there be on relative competitive advantages of different market participants if the short sale price test were based on an increment larger than a penny?

14. What impact, if any, would the trading requirements of Regulation NMS have on implementing the proposed modified uptick rule or proposed uptick rule?

15. To what extent does the ability to obtain a short position through the use of derivative products such as options, futures, contracts for difference, warrants, credit default swaps or other swaps (so-called ''synthetic short sales'') or other instruments (such as inverse leveraged exchange traded funds) undermine the goals of short sale price test restrictions, such as the proposed modified uptick rule and the proposed uptick rule? Will synthetic short sales increase if the Commission adopts either alternative short sale price test? What effects might such an increase have on market liquidity and pricing efficiency? Please explain.

16. Before determining whether to adopt a short sale price test restriction on a permanent basis, should we adopt a rule that would apply, on a pilot basis, the operation of a short sale price test restriction for specified securities? Such an approach would allow us to study the effects on, among other things, market volatility, price efficiency, and liquidity during the recent changes in market conditions. What would be other benefits of taking this approach? What would be the costs of taking this approach? Would the costs associated with programming systems to apply a short sale price test restriction on specified securities outweigh any benefits of having a pilot? If we were to take this approach, how long would it take to program systems to apply a short sale price test restriction to specified securities? Similar to the Pilot conducted immediately prior to the elimination of former Rule 10a–1, the securities that could be subject to the pilot could be comprised of a subset of the Russell 3000 index, or such other securities as necessary or appropriate in the public interest and consistent with the protection of investors after giving due consideration to the security's liquidity, volatility, market depth and trading market. Would it be appropriate for such a pilot to be comprised of a subset of the Russell 3000 index? How should the securities that would comprise a pilot be selected? Please explain the reasons for any suggested selection method. Such a pilot could remain in effect for one or two years. Would a one or two year pilot be an appropriate period of time? If so, why? If not, why not? Please provide specific reasons to support any views in favor of establishing another time period. Please provide any additional details regarding how a pilot could be structured in terms of the securities to be selected, the time-frame of the pilot, and the types of restrictions that could be placed on short selling of such securities.

17. In connection with the Pilot conducted immediately prior to our elimination of former Rule 10a–1, SROs publicly released transactional short selling data so that data would be available to the public to encourage independent researchers to study the Pilot. If we were to adopt a rule that would apply, on a pilot basis, a short sale price test restriction on specified securities, we would expect to make information obtained during any such pilot publicly available. In addition, we would expect SROs to again make data available to the public during any such pilot. Would there be any costs associated with making short selling data available to the public during the period of a pilot? What would be the benefits of making such data available to the public?

18. Commenters have stated that the Pilot conducted prior to the elimination of former Rule 10a–1 was insufficient, in part, because it only covered a period

of relative market stability [282] and that the Pilot should have lasted longer to ''ensure at least one bear market was involved in the study.'' [283] Did the Pilot cover a sufficient period of time?

19. The proposed implementation period for both of the proposed rules would be three months from the effective date of the proposed rule, if adopted. Would a three month implementation period be appropriate for the proposed modified uptick rule? Would a three month implementation period be appropriate for the proposed uptick rule? Should there be a shorter or longer implementation period for either proposed rule? Please explain.

Questions Regarding Proposed Modified Uptick Rule

1. The proposed modified uptick rule would define the term ''down-bid price'' to mean a price that is less than the current national best bid or, if the last differently priced national best bid was greater than the current national best bid, a price that is less than or equal to the current national best bid. Should this definition be altered? If the last differently priced national best bid was greater than the current national best bid, should short selling be restricted to a cent above the current national best bid, or a higher or lower increment? If so, why? If a specific increment is suggested, please describe what impact such increment would have on short selling. What increment, if any, would be tantamount to a ban on short selling? Please provide empirical data in support of any arguments and/or analyses.

2. The proposed modified uptick rule would allow short selling at the current national best bid in an advancing market. Should the proposed modified uptick rule instead require a trading center to have policies and procedures reasonably designed to permit short selling only at a price above the current national best bid such that short selling would occur only at a higher price than the current national best bid, and only on a passive basis? Would such an approach be more effective at preventing short selling, including potentially manipulative or abusive short selling, from being used as a tool to drive down the market or from being used to accelerate a declining market than the approach set forth in the proposed modified uptick rule or proposed uptick rule? If so, how? If not, why not? What effect would an approach that allows short selling only at a price above the current national best bid have on the benefits of short selling, such as providing price efficiency and liquidity? Would this approach be easier to program into trading and surveillance systems than the approach in the proposed modified uptick rule or proposed uptick rule? If so, why? If not, why not? Should an approach that allows short selling only at a price above the current national best bid be combined with a policies and procedures approach similar to that discussed under the proposed modified uptick rule or a prohibition approach similar to that discussed under the proposed uptick rule? What would be the advantages and disadvantages, including costs and benefits of each of these approaches as combined with a short sale price test that permits short selling only at a price above the current national best bid?

3. The proposed modified uptick rule would apply to a ''covered security'' which is defined to mean an NMS stock as that term is defined in Regulation NMS. Is it appropriate for the proposed modified uptick rule to apply only to NMS stocks? Should the definition of a ''covered security'' instead be a security that is registered on, or admitted to unlisted trading privileges on, a national securities exchange? If so, why? If not, why not? Should the definition of ''covered security'' be expanded to include all NMS securities, including options? If so, why? If not, why not?

4. Should the proposed modified uptick rule be extended to Non-NMS stocks, such as stocks quoted on the OTC Bulletin Board and Pink Sheets? How would a national best bid be determined for sales of such securities?

5. The proposed modified uptick rule has as its reference point for a permissible short sale the current national best bid in relation to the last differently priced national best bid. To what extent would the sequence of bids play a role in determining when short sales can be executed or displayed by trading centers, or submitted by broker-dealers relying on the exception to the proposed modified uptick rule in proposed Rule 201(c)? Are there any regulatory or operational reasons to allow markets to use their own bid information in regulating short sales under the proposed modified uptick rule? Would allowing markets to use their own bid information affect the operation or effectiveness of the proposed modified uptick rule? If so, how? If trading centers and broker-dealers marking orders ''short exempt'' pursuant to proposed Rule 201(c) take snapshots of the market at the time of execution, display, or submission of the short sale order, as applicable, would such snapshots address any concerns regarding the sequence of bids? If not, what other policies and procedures could trading centers and broker-dealers put in place to address these concerns?

6. The proposed modified uptick rule would require trading centers to establish, maintain, and enforce written policies and procedures reasonably designed to prevent the execution or display by the trading center of impermissibly priced short sale orders. Are the proposed modified uptick rule's requirements for what trading centers' policies and procedures would be required to include appropriate? Please explain. Pursuant to proposed Rule 201(b)(1)(ii) a trading center's policies and procedures must be reasonably designed to permit the execution or display of a short sale order of a covered security marked ''short exempt'' without regard to whether the order is at a down-bid price. Thus, a trading center's policies and procedures must be able to recognize an order marked ''short exempt.'' Is the inclusion of this requirement in a trading center's policies and procedures appropriate? Please explain.

7. Proposed Rule 201(b)(2) would require that trading centers regularly surveil to ascertain the effectiveness of the policies and procedures required by proposed Rule 201(b)(1) and promptly take action to remedy deficiencies in such policies and procedures. Would all trading centers readily be able to monitor on a real-time basis the national best bid and the last differently priced national best bid? Are there other ways to surveil that would not be on a real-time basis that would be equally or more effective? Please explain. What systems and surveillance changes by trading centers would be necessary to meet the requirements of the proposed modified uptick rule? Should additional requirements be placed on trading centers that execute or display short sale orders in covered securities? If so, what should such requirements be? Is a policies and procedures approach preferable to a prohibition (as was the case under former Rule 10a–1) on any person executing a short sale on a down-bid price? What would be the costs and benefits of a policies and procedures approach as compared to such a prohibition? Should the Commission consider instead a prohibition with regard to some or all of the entities regulated by the Commission, rather than one on ''any person,'' as was the case under former Rule 10a–1? What about an approach that imposed a policies and procedures requirement on some or all of the entities regulated by the Commission *and* a prohibition on ''any person''?

[282] *See* Brown Letter *supra* note 55.

[283] *See id.*

What would be the costs and benefits of an approach that used both a prohibition and a policies and procedures requirement on some or all of the entities regulated by the Commission? What would be the costs and benefits of each of these approaches?

8. Under the proposed modified uptick rule, a trading center or broker-dealer, as applicable, would need to take such steps as would be necessary to enable it to enforce its policies and procedures effectively. For example, trading centers and broker-dealers, as applicable, could establish policies and procedures that could include regular exception reports to evaluate their trading practices. Should the proposed modified uptick rule require trading centers and broker-dealers subject to the policies and procedures requirements of the rule to have exception reports? Please explain. What would be the costs and benefits of such a requirement? Would such costs and benefits differ depending on the size of the trading center or broker-dealer?

9. Under the proposed modified uptick rule, if an order is impermissibly priced, the trading center could re-price the order at the lowest permissible price and hold it for later execution at its new price or better. As quoted prices change, the proposed modified uptick rule would allow a trading center to repeatedly re-price and display an order at the lowest permissible price down to the order's original limit order price (or, if a market order, until the order is filled). In effect, what would be the consequences of the proposed modified uptick rule? What would be the impact of the proposed modified uptick rule on speed of executions, transaction costs, and order flow? In addition, if a trading center were not to re-price an order, what would be the impact on speed of executions, transaction costs, and order flow?

10. Proposed Rule 201(b)(1)(i) provides that a trading center's policies and procedures must be reasonably designed to permit the execution of a displayed short sale order of a covered security if, at the time of display of the short sale order, the order was not at a down-bid price. Is it appropriate that the proposed modified uptick rule would not preclude execution of a short sale order that was not priced in accordance with proposed Rule 201(b)(1) provided that the short sale order complied with the requirements of proposed Rule 201(b)(1) at the time it was displayed? If so, why? If not, why not? Please explain.

11. Proposed Rule 201(c) provides that a broker-dealer may mark an order ''short exempt'' provided the broker-dealer complies with the requirements of that paragraph of the proposed rule. Would it be appropriate to permit a broker-dealer to mark a short sale order ''short exempt'' if it complies with the requirements of paragraph (c) of the proposed rule? Should this provision apply to entities other than, or in addition to, broker-dealers? Would the determination of the down-bid price for certain orders at the time of submission and others at the time of execution or display cause unnecessary confusion in the market? What systems and surveillance changes by broker-dealers would be necessary to meet the requirements of this provision?

12. The proposed modified uptick rule would not apply at times the national best bid is not collected, processed, and disseminated. Is this appropriate? Would this result in a substantial portion of short selling moving to times when the national best bid is not collected, processed, and disseminated? Would this undermine the effectiveness of the proposed modified uptick rule at helping to prevent short selling, including potentially abusive or manipulative short selling, from being used as a tool to drive down markets or to accelerate a price decline? Should the proposed modified uptick rule apply even at times the national best bid is not collected, processed, and disseminated? If so, why? If not, why not? If it were to apply during trading sessions when the national best bid is not collected, processed, and disseminated, how should it apply (*e.g.,* using the national best bid at the end of the trading session)? What would be the costs and benefits of applying the proposed modified uptick rule at times the national best bid is not collected, processed, and disseminated, including the impact on liquidity and price efficiency? What would be the costs and benefits of applying the proposed modified uptick rule at times the national best bid is collected, processed, and disseminated, including the impact on liquidity and price efficiency?

13. The proposed modified uptick rule includes a number of provisions that would permit a broker-dealer to mark a short sale order ''short exempt.'' Pursuant to proposed Rule 201(b)(1)(ii) a trading center's policies and procedures must be reasonably designed to permit the execution or display of a short sale order marked ''short exempt'' without regard to whether the order is at a down-bid price. In addition to the provisions under paragraphs (c) and (d) of the proposed modified uptick rule regarding when a broker-dealer may mark an order ''short exempt,'' are there other provisions that the proposed modified uptick rule should include? Should the proposed modified uptick rule permit a broker-dealer to make a short sale order ''short exempt'' in connection with short selling activity and electronic trading systems that match and execute customer orders at random times within specific time intervals, and at independently derived prices? If so, please explain. If such a provision would be appropriate or necessary, what conditions should apply? Should such a provision include conditions similar to the conditions set forth in Rule 201(c)(8) of the proposed uptick rule? Should the proposed modified uptick rule permit a broker-dealer to mark a short sale order ''short exempt'' in connection with locked or crossed markets? If so, please explain how a conflict could arise in connection with the proposed modified uptick rule and locked or crossed markets and what should be the conditions of any such provision. Should the proposed modified uptick rule permit a broker-dealer to make a short sale order ''short exempt'' when the broker-dealer is fulfilling specific obligations? If so, please explain.

14. Would any of the provisions under paragraph (c) or (d) under the proposed modified uptick rule be susceptible to abuse? If so, how? Are there conditions that would address this concern?

15. Proposed Rule 201(d)(1) would permit a broker-dealer to mark a short sale order of a covered security ''short exempt'' if the seller owns the security sold and intends to deliver the security as soon as all restrictions on delivery have been removed. Would this provision be necessary or appropriate? Should any conditions or limitations apply? If so, why? If not, why not?

16. Proposed Rule 201(d)(2) would permit a broker-dealer to mark a short sale order of a covered security ''short exempt'' in connection with certain odd lot transactions. Is this provision necessary or appropriate? Should proposed Rule 201(d)(2) apply to all market makers in odd-lots or should it be more limited? If so, why and how?

17. Proposed Rule 201(d)(3) would permit a broker-dealer to mark a short sale order of a covered security ''short exempt'' in connection with certain bona fide domestic arbitrage transactions. Would this provision be necessary or appropriate? Should the provision be narrowed or broadened? If so, state specifically why, and how it should be restructured in relation to the purposes of the proposed modified uptick rule. Proposed Rule 201(d)(3)

parallels the exception in former Rule 10a–1(e)(7) which, consistent with Regulation T at the time, referred to a ''special arbitrage account.'' Because Regulation T no longer refers to a ''special arbitrage account'' but instead refers to a ''good faith account'', proposed Rule 201(d)(3) would also refer to a ''good faith account.'' Should proposed Rule 201(d)(3) refer to a ''special arbitrage account'' or a ''good faith account''? Please explain. Is a separate account, whether a ''special arbitrage account'' or ''good faith account,'' necessary or appropriate for this provision? If so, why? If not, why not?

18. Proposed Rule 201(d)(4) would permit a broker-dealer to mark a short sale order of a covered security ''short exempt'' in connection with certain international arbitrage transactions. Would this provision be necessary or appropriate? Should the provision be narrowed or broadened? If so, state specifically why, and how it should be restructured in relation to the purposes of the proposed modified uptick rule. Proposed Rule 201(d)(4) parallels the exception in former Rule 10a–1(e)(8) which, consistent with Regulation T at the time, referred to a ''special international arbitrage account.'' Because Regulation T no longer refers to a ''special international arbitrage account'' but instead refers to a ''good faith account,'' proposed Rule 201(d)(4) would also refer to a ''good faith account.'' Should proposed Rule 201(d)(4) refer to a ''special international arbitrage account'' or a ''good faith account''? Please explain. Is a separate account, whether a ''special arbitrage account'' or ''good faith account,'' necessary or appropriate for this provision? If so, why? If not, why not? Should proposed Rule 201(d)(4) be combined with proposed Rule 201(d)(3)? If so, why? If not, why not? Should depository receipts of a security be deemed the same security as the security represented by such depository receipt? Why or why not?

19. Proposed Rule 201(d)(5) would permit a broker-dealer to mark a short sale order of a covered security ''short exempt'' in connection with sales by underwriters or syndicate members participating in a distribution in connection with over-allotments, and lay-off sales by such persons in connection with a distribution of securities. Would this provision be necessary or appropriate for both and/or either over-allotments and lay-off sales? Under what circumstances would an underwriter or syndicate member price an offering below the national best bid? What market impact, if any, would there be if the provision were extended to short sales below the national best bid?

20. Proposed Rule 201(d)(6) would permit a broker-dealer to mark a short sale order of a covered security ''short exempt'' where a broker-dealer is facilitating customer buy or long sale orders on a riskless principal basis. Would this provision be appropriate or necessary? Are the conditions set forth in proposed Rule 201(d)(6) appropriate? Should the conditions be narrowed or broadened in any way? Please explain.

21. Proposed Rule 201(d)(7) would permit a broker-dealer to mark a short sale order of a covered security ''short exempt'' in connection with certain VWAP transactions. Would this provision be necessary or appropriate? Should the proposed provision be modified in any way? If so, please explain. Are all of the proposed conditions appropriate, or should any be eliminated or modified? Should any other conditions be added? In place of a provision limited to VWAP transactions, would it be more appropriate to permit a broker-dealer to mark a short sale order of a covered security ''short exempt'' in connection with ''any short sale at a price that is not based, directly or indirectly, on the quoted price of the covered security at the time of execution and for which the material terms were not reasonably determinable at the time the commitment to execute the order was made''? [284] If this provision would be more appropriate, please explain why. What types of benchmark orders would such a provision capture? If we were to use this alternative language, how should we determine the ''material terms'' of the short sale? Should there be any conditions on the use of this alternative proposed provision?

22. Should the proposed modified uptick rule include a ''short exempt'' marking provision specific to the daily opening of trading at each trading center, particularly given that there are multiple trading centers with non-synchronous opening auctions? Please explain. Should there be a ''short exempt'' marking provision specific to the opening of trading after a trading halt? Please explain. Should there be a ''short exempt'' marking provision specific to short selling at the closing of trading at each trading center? Please explain.

23. Should the proposed modified uptick rule include a ''short exempt'' marking provision for transactions in exchange traded funds and similar products? If so, what should be the qualifications and/or conditions related to such provision? We note the Commission previously exempted ETFs from Rule 10a–1, subject to various conditions.[285]

24. Should the proposed modified uptick rule include a ''short exempt'' marking provision for short sale orders that are not pursuant to a ''regular way'' contract?

25. The proposed modified uptick rule does not contain a ''short exempt'' marking provision in connection with market makers engaged in bona fide market making activity. Should there be such a provision to facilitate market making activity by broker-dealers? If so, why? What consequences would there be, if any, to the markets if broker-dealers are not permitted to mark such orders ''short exempt''? Please describe. If the proposed modified uptick rule were to permit broker-dealers to mark short sale orders pursuant to bona fide market making activity as ''short exempt'' what qualifications and/or conditions should apply?

26. When the Commission repealed short sale price tests in 2007, it also provided that no SRO could have or adopt its own short sale price test. One reason for removing short sale price tests was the existence of different types of prices tests (*e.g.,* the tick test of Rule 10a–1 and the NASD bid test). Should the proposed modified uptick rule be an SRO rule?

27. Under a straight prohibition, any person is liable for an impermissible short sale, even if the sale is the product of an error. Should we include an exception for inadvertent errors, if the person can demonstrate that the error was inadvertent? When would an inadvertent error occur? How could a person demonstrate that the non-compliant short sale was an inadvertent error?

28. The short sales that qualify for the ''broker-dealer'' provision in proposed Rule 201(c) are still subject to the provisions of the proposed modified uptick rule and would be required to be marked as ''short exempt.'' Should these short sales be marked as ''short exempt'' or is another mark more appropriate? What effect, if any, would marking these short sales as ''short exempt'' have on compliance or surveillance relative to another mark? What would be the costs associated with implementing a mark especially for these short sales?

Questions Regarding Proposed Uptick Rule

1. Should the proposed uptick rule have a policies and procedures approach for some or all of the entities

[284] *See also* 17 CFR 242.611(7).

[285] *See, e.g.,* 2003 Proposing Release at 62988.

regulated by the Commission similar to the approach under the proposed modified uptick rule? If so, why? If not, why not? Or, should the Commission *also* adopt a prohibition on ''any person'' for the proposed uptick rule, in addition to a policies and procedures requirement on some or all of the entities regulated by the Commission? What would be the costs and benefits of a policies and procedures requirement, as compared to the proposed prohibition? What would be the costs and benefits of an approach that used both a prohibition and a policies and procedures requirement on some or all of the entities regulated by the Commission?

2. The proposed uptick rule would apply to a ''covered security'' which is defined as an NMS security, other than an option, in which trades in such securities are reported pursuant to an effective transaction reporting plan and for which information as to such trades is made available in accordance with such plan on a real-time basis to vendors of market transaction information. Should the definition of a ''covered security'' be changed to apply to a security registered on, or admitted to unlisted trading privileges on, a national securities exchange, if trades in such securities are reported pursuant to an effective transaction reporting plan and information as to such trades is made available in accordance with such plan on a real-time basis to vendors of market transaction information? If so, why? Would such a definition result in securities other than NMS stocks being subject to the proposed uptick rule? If so, please describe those types of securities and the costs and benefits of applying the proposed uptick rule to such securities. Should the definition of ''covered security'' be expanded to include all NMS securities, including options? If so, why? If not, why not?

3. The proposed uptick rule would apply to NMS stocks quoted in the OTC market, but not to non-NMS stocks quoted in the OTC market. What form of price test, if any, should apply to non-NMS stocks quoted in the OTC market, and why? If a price test should apply to non-NMS stocks, to what types of non-NMS stocks should it apply? Please explain. How should such a price test be implemented? In addition, we seek comment regarding whether the market is structured in a manner that would make regulation of non-NMS stocks practical.

4. Could any operational concerns regarding implementation of the proposed uptick rule be remedied by market participants taking snapshots of the market at the time of effecting a short sale? Such snapshots could provide a record of the last sale price and the direction of the market for a particular security at the time of effecting the short sale. Would any additional exceptions be necessary to address time lags in the receipt of last sale price information from data feeds? If so, please explain, including providing any suggested language for such an exception.

5. The proposed uptick rule would not apply to short sales in covered securities while last sale price information is not collected, calculated and disseminated on a real-time basis. Would this result in a substantial portion of short selling moving to times when last price information is not collected, calculated, and disseminated on a real-time basis? Would this undermine the effectiveness of the proposed modified uptick rule at helping to prevent short selling, including potentially abusive or manipulative short selling, from being used as a tool to drive down markets or to accelerate a price decline? Would it be appropriate to apply the proposed uptick rule while last sale price information is not collected, calculated and disseminated on a real-time basis? Please explain. What would be the costs and benefits of applying the proposed uptick rule during after-hours trading sessions, including the impact on liquidity and price efficiency? Please explain. What would be the costs and benefits of not applying the proposed uptick rule during after-hours trading sessions, including the impact on liquidity and price efficiency? Please explain.

6. Former Rule 10a–1 included a provision that permitted markets to use the last sale prices on their own markets as the reference point for measuring the permissibility of short sales. Specifically, former Rule 10a–1(a)(2) provided: ''* * * any exchange, by rule, may require that no person shall, for his own account or the account of any other person, effect a short sale of any such security on that exchange (i) below the price at which the last sale thereof, regular way, was effected on such exchange, or (ii) at such price unless such price is above the next preceding different price at which a sale of such securities, regular way, was effected on such exchange, if that exchange determines that such action is necessary or appropriate in its market in the public interest or for the protection of investors; and, if an exchange adopts such a rule, no person shall, for his own account or for the account of any other person, effect a short sale of any such security on such exchange otherwise than in accordance with such rule * * *.'' This provision was added to former Rule 10a–1 in response to certain SROs asserting that the last trade price on the consolidated system should not be the reference point for the tick test of former Rule 10a–1 because last trade price data was not available in a timely manner and because the principal exchanges did not have adequate information retrieval systems on their floors to ensure adherence with former Rule 10a–1.[286] Should the proposed uptick rule include a similar provision? With the spread of fully automated markets and the advances in the dissemination of market information, is such a provision necessary or desirable in today's markets? Please explain the costs and benefits of permitting each market to use the last sale price in its market as the reference point under the proposed uptick rule.

7. Former Rule 10a–1(a)(3) included a provision that allowed for an adjustment to the sale price of a security after the security went ex-dividend, ex-right, or ex any other distribution when determining the price at which a short sale may be effected. Specifically, former Rule 10a–1(a)(3) provided: ''In determining the price at which a short sale may be effected after a security goes ex-dividend, ex-right, or ex-any other distribution, all sale prices prior to the ''ex'' date may be reduced by the value of such distribution.'' Would this provision be necessary under the proposed uptick rule? Please explain.

8. Former Rule 10a–1(e)(6) contained an ''equalizing exception'' that applied to securities registered on, or admitted to unlisted trading privileges on, a national securities exchange, for which trades in such securities were not reported to an effective transaction reporting plan and for which information as to such trades was not made available in accordance with such plan on a real-time basis to vendors of market transaction information. For such securities, it allowed short sales to be effected on a national securities exchange (provided the exchange approved the sale), if such sale was necessary to equal the price of the security on that exchange with the price of the security on the principal exchange for the security. The Commission stated that this exception

[286] *See* Securities Exchange Act Release No. 11276 (Mar. 5, 1975), 54 FR 12522 (Mar. 19, 1975) (release proposing subparagraph (a)(2) in response to stated operational and other difficulties associated with complying with Rule 10a–1); *see also* Securities Exchange Act Release No. 11468 (June 12, 1975), 40 FR 25442 (June 16, 1975) (adoption of proposed changes adding subparagraph (a)(2)).

was afforded to persons on regional exchanges to enhance the liquidity on those exchanges with respect to orders naturally flowing to those exchanges.[287] The Commission also noted, however, that the exception may have resulted in providing an incentive to divert orders from the principal exchange market to avoid the impact of former Rule 10a–1, because it allowed short sales to be effected on regional exchanges at prices below the last sale price on the principal exchange.[288] We have determined not to include this exception in the proposed uptick rule because we believe it would not make sense in light of the proposed reference point (the last sale reference point in the consolidated system). The exception in former Rule 10a–1(e)(6) was originally adopted in 1938 when the permissibility of short sales under former Rule 10a–1 was determined for each particular exchange by comparing the price of the proposed short sale to the immediately preceding price of the security to be sold short on that exchange. The exception was modified, but retained, following amendments to former Rule 10a–1 to reference the last trade price reported to the consolidated system or in a particular exchange market. The proposed uptick rule uses as the reference price the last sale price reported pursuant to an effective transaction reporting plan only. Thus, we believe a similar exception to the exception contained in former Rule 10a–1(e)(6) would not be necessary. Are there any reasons to include in the proposed uptick rule a similar exception to that contained in former Rule 10a–1(e)(6)? Please explain.

9. As discussed in detail above under Section III.B.2.c. we have incorporated into proposed Rule 201(c)(10) and (c)(11), proposed exceptions to address any potential conflict between the proposed uptick rule and the Quote Rule arising from a trade-through. These exceptions are substantially in the form in which they were included in subsections (e)(5)(ii) and (e)(11) of former Rule 10a–1. Are these exceptions appropriate or necessary? Should these exceptions be revised in any way? If so, please provide suggested language. Proposed Rule 201(c)(10) would allow an SRO, by rule, to prohibit its registered specialists and registered exchange market makers from availing themselves of the exemption afforded by paragraph (c)(10) if that SRO determines that such action is necessary or appropriate in its market in the public interest or for the protection of investors. Is this provision appropriate or necessary? Would any SRO avail itself of this provision? If not, why not? If so, why and how?

10. Former Rule 10a–1 contained an exception in paragraph (e)(5)(i) that permitted market makers to effect short sales at the same price as the last sale price even if the last sale price was on a zero-minus tick. Specifically, former Rule 10a–1(e)(5)(i) provided an exception for: ''Any sale of a security * * * (except a sale to a stabilizing bid complying within Rule 104 of Regulation M) by a registered specialist or registered exchange market maker for its own account on any exchange with which it is registered for such security, or by a third market maker for its own account over-the-counter, i. Effected at a price equal to or above the last sale, regular way, reported for such security pursuant to an effective transaction reporting plan * * * *Provided, however,* That any exchange, by rule, may prohibit its registered specialist and registered exchange market makers from availing themselves of the exemption afforded by this paragraph (e)(5) if that exchange determines that such action is necessary or appropriate in its market in the public interest or for the protection of investors.'' Unless prohibited by exchange rule, this exception was intended to permit registered specialists or market makers to protect customer orders against transactions in other markets in the consolidated system by allowing them to sell short at a price equal to the last trade price reported to the consolidated system, even if that sale was on a minus or zero-minus tick.[289] Although former Rule 10a–1 included this exception for market makers, exchanges adopted rules that prohibited their registered specialists and market makers from availing themselves of this exception.[290] Thus, we have determined not to include a similar exception in the proposed uptick rule.[291] Would a similar exception under the proposed uptick rule for registered market makers be appropriate or necessary? If the proposed uptick rule were to include a similar exception, should the exception be substantially in the form in which it was included in former Rule 10a–1(e)(5)(i)? If so, why? If not, why not? Please explain any recommended changes.

11. The proposed uptick rule would include a number of exceptions. In addition to the exceptions contained in the proposed uptick rule, are there other exceptions that should be included? For example, should the Commission provide an exception from the proposed uptick rule for transactions in exchange traded funds? If so, what should be the qualifications and/or conditions for relief? If not, please explain why not. In addition, we note that under former Rule 10a–1 the Commission granted conditional relief to allow requesting exchanges[292] and broker-dealers[293] to execute short sales in after-hours crossing sessions at a price equal to the closing price of the security.[294] Absent relief, such short sales could have violated former Rule 10a–1 in that the matching price (the closing price) of a security could have been on a minus or zero-minus tick with respect to the last sale in the consolidated transaction reporting system. In granting this conditional relief, the Commission noted that short sale transactions executed at the closing price generally do not represent the type of abusive practices that former Rule 10a–1 was designed to prevent. In particular, the Commission stated that short sale orders entered in the after-hours crossing sessions cannot influence the matching price, but rather are priced by unrelated order flow and transactions occurring during the primary trading session, which are subject to former Rule 10a–1. Should we codify the exemptive

[287] *See* Securities Exchange Act Release No. 11468 (June 12, 1975), 40 FR 25442 (June 16, 1975) (adopting amendments to Rule 10a–1 and discussing the operation of Rule 10a–1(e)(6) as in effect prior to and after amendment).

[288] *See id.*

[289] *See supra* note 188. Former Rule 10a–1(a)(1)(i) referenced the last sale price reported to an effective transaction reporting plan, but former Rule 10a–1(a)(2) also permitted an exchange to make an election to use the last sale price reported in that exchange market. Certain exchanges, such as the NYSE, implemented short sale price test rules consistent with former Rule 10a–1(a)(2). *See, e.g.,* former NYSE Rule 440B.

[290] *See* former NYSE Rule 440B.

[291] *See supra* Section III.A.2.i. (discussing our decision not to propose that a broker dealer may mark an order ''short exempt'' in connection with bona fide market making activity).

[292] *See, e.g.,* letter re: Off-Hours Trading by the Amex, [1991] Fed. Sec. L. Rep. (CCH) ¶ 79,802 (Aug. 5, 1991); letter re: Operation of Off-Hours Trading by the NYSE, [1991] Fed. Sec. L. Rep. (CCH) ¶ 79,736 (June 13, 1991).

[293] *See, e.g.,* letter re: Burlington Capital Markets (July 1, 2003); letter re: Bear, Stearns & Co., Inc. (Jan. 19, 1996); Letter re: AZX, Inc. (Nov. 15, 1995); letter re: Instinet Corporation Crossing Network, [1992] Fed. Sec. L. Rep. (CCH) ¶ 76,290 (July 1, 1992); letter re: Portfolio System for Institutional Trading, [1991–1992] Fed. Sec. L. Rep. (CCH) ¶ 76,097 (Dec. 31, 1991).

[294] The relief was generally subject to the conditions that: (1) Short sales of a security in the after-hours matching session shall not be effected at prices lower than the closing price of the security on its primary exchange; (2) persons relying on these exemptions shall not directly or indirectly effect any transactions designed to affect the closing price on the primary exchange for any security traded in the after-hours matching session; and (3) transactions effected in the after-hours matching session shall not be made for the purpose of creating actual, or apparent, active trading in or otherwise affecting the price of any security.

relief granted under former Rule 10a–1 as an exception from the proposed uptick rule? Under current market conditions, do closing price transactions create potentially manipulative incentives for broker-dealers, such that they should not be granted an exception?

12. Proposed Rule 201(c)(1) would provide an exception to allow short sales to be submitted without regard to the proposed uptick rule if the seller owns the security sold and the seller intends to deliver the security as soon as all restrictions on delivery have been removed. Would this exception be necessary or appropriate? Should any conditions or limitations apply to the exception? If so, why? If not, why not?

13. Proposed Rule 201(c)(2) would provide an exception for any sale by a broker-dealer of a covered security for an account in which it has no interest pursuant to an order marked ''long.'' Would this exception be appropriate or necessary? Should any conditions or limitations apply to the exception? If so, why? If not, why not?

14. Proposed Rule 201(c)(3) would provide a limited exception for odd lot transactions. Would this exception be appropriate or necessary? Should the proposed exception apply to all market makers in odd-lots or should the exception be more limited? Would this exception be susceptible to abuse? If so, how? Should all odd-lot transactions have an exception from the proposed uptick rule? Would providing an exception for all odd-lot transactions result in a risk of increased short sale manipulation, *e.g.,* would traders break up trades into 99 share odd-lots in order to avoid the proposed uptick rule?

15. Proposed Rule 201(c)(4) would provide an exception from the proposed uptick rule for certain bona fide domestic arbitrage transactions. Should the exception be narrowed or broadened? If so, state specifically why, and how it should be restructured in relation to the purposes of the proposed uptick rule. Proposed Rule 201(c)(4) parallels the exception in former Rule 10a–1(e)(7) which, consistent with Regulation T at the time, referred to a ''special arbitrage account.'' Because Regulation T no longer refers to a ''special arbitrage account'' but instead refers to a ''good faith account'', proposed Rule 201(c)(4) would also refer to a ''good faith account.'' Should proposed Rule 201(c)(4) refer to a ''special arbitrage account'' or a ''good faith account''? Please explain.

16. Proposed Rule 201(c)(5) would provide an exception from the proposed uptick rule for certain international arbitrage transactions. Should the proposed exception be narrowed or broadened? If so, state specifically why, and how it should be restructured in relation to the purposes of the proposed uptick rule. Proposed Rule 201(c)(5) parallels the exception in former Rule 10a–1(e)(8) which, consistent with Regulation T at the time, referred to a ''special international arbitrage account.'' Because Regulation T no longer refers to a ''special international arbitrage account'' but instead refers to a ''good faith account'', proposed Rule 201(c)(5) would also refer to a ''good faith account.'' Should proposed Rule 201(c)(5) refer to a ''special international arbitrage account'' or a ''good faith account''? Please explain. Should proposed Rule 201(c)(4) be combined with proposed Rule 201(c)(5)? If so, why? If not, why not? Should depository receipts of a security be deemed the same security as the security represented by such depository receipt? Why or why not?

17. Proposed Rule 201(c)(6) would provide an exception from the proposed uptick rule for sales by underwriters or syndicate members participating in a distribution in connection with over-allotments and lay-off sales by such persons in connection with a distribution of securities. Under what circumstances would an underwriter or syndicate member price an offering below the last sale? What market impact, if any, would there be if the exception were extended to short sales below the last sale?

18. Would the exception for VWAP transactions contained in proposed Rule 201(c)(7) be appropriate or necessary? Are all of the proposed conditions appropriate, or should any be eliminated or modified? Should any other conditions be added? Should the proposed exception be modified in any way? If so, please explain. Would the following exception be more appropriate for excepting transactions such as short sale orders on a VWAP basis: The provisions of the proposed uptick rule shall not apply to ''any short sale at a price that was not based, directly or indirectly, on the quoted price of the covered security at the time of execution and for which the material terms were not reasonably determinable at the time the commitment to execute the order was made''? [295] If this exception would be more appropriate, please explain why. What types of benchmark orders would such an exception capture? If we were to use this alternative language, how should we determine the ''material terms'' of the short sale? Should there be any conditions on the use of this alternative proposed exception?

19. Would the exception for transactions pursuant to certain electronic trading systems that match buying and selling interest in proposed Rule 201(c)(8) be appropriate? Should the proposed exception be modified in any way? If so, please explain.

20. Proposed Rule 201(c)(9) would provide an exception from the proposed uptick rule for broker-dealers facilitating customer buy or long sale orders on a riskless principal basis. Are the conditions set forth in proposed Rule 201(c)(9) in connection with the ''riskless principal'' exception appropriate? Should the conditions be narrowed or broadened in any way? Please explain.

21. Proposed Rule 201(c)(12) would provide for an exception from the proposed uptick rule for short sales by registered market makers or specialists publishing two-sided quotes to sell short to facilitate customer market and marketable limit orders regardless of the last sale price. Would this proposed exception be appropriate? Should additional qualifications and/or conditions be placed on such a proposed exception? If so, please describe any such qualifications and/or conditions including the purpose of such qualifications and/or conditions. Is this proposed exception necessary in highly liquid securities where there is likely to be sufficient selling interest without the specialist's or market maker's quote? Should this proposed exception be limited in some way? Please explain.

22. Should there be an exception specific to the daily opening of trading at each trading center, particularly given that there are multiple trading centers with non-synchronous opening auctions? Please explain. Should there be an exception specific to the opening of trading after a trading halt? Please explain. Should there be an exception specific to short selling at the closing of trading at each trading center? Please explain.

23. Under the proposed uptick rule, short sales could not be executed at a price below the last sale price of a security. In addition, short sale orders could be executed at the last sale price only if it is higher than the last different price for the security. Is a one-cent trading increment appropriate for the proposed uptick rule? Why or why not? If a higher increment is suggested, please describe what impact such increment would have on short selling. What increment, if any, would be tantamount to a ban on short selling?

[295] *See also* 17 CFR 242.611(a)(7).

Please provide empirical data in support of any arguments and/or analyses.

24. When the Commission repealed short sale price tests in 2007, it also provided that no SRO could have or adopt its own short sale price test. One reason for removing short sale price tests was the existence of different types of prices tests (*e.g.*, the tick test of Rule 10a–1 and the NASD bid test). Should the proposed uptick rule be an SRO rule?

Questions Regarding Circuit Breakers Generally

1. The Commission believes that the erosion of investor confidence and questions concerning the volatility in the securities markets necessitate review of various alternatives with respect to short selling restrictions. Would a short selling circuit breaker be more appropriate than a market-wide short sale price test restriction in current market conditions? If so, why? If not, why not? Would a short selling circuit breaker provide more potential benefit to the market than a market-wide short sale price test restriction? Please explain. For example, would a short selling circuit breaker be a more appropriate means for the Commission to achieve the objective of helping to prevent short selling from being used as a tool to drive down the market? Please explain. Would a short selling circuit breaker rule help to address the Commission's concerns regarding investor confidence? If so, why and how? If not, why not?

2. Would implementation of a circuit breaker be less or more costly than the implementation of a market-wide short sale price test restriction? The proposed circuit breaker rules would, when triggered, impose short selling restrictions for the trading day on which the circuit breaker is triggered. Should the circuit breaker rules instead impose short sale price tests for multiple days? How many days? Would there be any additional costs associated with a circuit breaker that persisted for multiple trading days? Would a circuit breaker that when triggered imposed a temporary halt on short selling be more or less costly than one that resulted in a short sale price test restriction? Please explain. Would a short selling circuit breaker be generally easier to implement in a Regulation NMS environment than a market-wide short sale price test restriction such as the proposed modified uptick rule, or the proposed uptick rule.

3. To which securities should a short selling circuit breaker apply? Should a short selling circuit breaker apply to all NMS stocks? If so, why? If not, why not and to which securities should a short selling circuit breaker apply? Should a short selling circuit breaker also apply to securities traded over-the-counter?

4. The Commission is seeking comment on the potential impacts of a short selling circuit breaker on market function and efficiency. What would be the impact of a short selling circuit breaker when triggered on the liquidity of individual securities? What would be the impact of a short selling circuit breaker on capital formation? What would be the impact of a short selling circuit breaker on price discovery? Would different circuit breaker alternatives have different impacts on liquidity, capital formation and price discovery? Would a multiple day circuit breaker pose any unique costs? Please explain.

5. Would circuit breakers pose any unique issues related to the daily opening of trading, the opening of trading after a trading halt, or the closing of trading? Please explain.

6. Should a short selling circuit breaker be limited in its application to specific industry sectors that are historically susceptible to extreme volatility or disproportionately high levels of short selling? If so, why? If not, why not? If a circuit breaker should be limited to apply only to certain sectors, what sectors should be included? Please explain. For example, should a circuit breaker apply only to the financial sector? If so, how should the financial sector be defined for purposes of determining which issuers' securities are subject to the circuit breaker thresholds? Please explain.

7. Currently, the marketwide circuit breaker rules are SRO rules. Should a short selling circuit breaker be a SRO rule or a Commission rule? Who should be responsible for implementing a short selling circuit breaker? Should trading centers be responsible for implementing a short selling circuit breaker when triggered? Should any person effecting a short sale be responsible for implementing a short selling circuit breaker? Should market participants be responsible for programming their own systems to prevent submission of a short sale order in violation of the circuit breaker? Please explain.

8. Who should be responsible for monitoring the price declines of individual securities that may trigger the short selling circuit breaker (*e.g.*, broker-dealers, SROs)? Please explain. How should information about the triggering of a circuit breaker in an individual security be disseminated to the market? Who should be responsible for disseminating that information? For example, the CMS is the primary means of dissemination for the current SRO Circuit Breakers and regulatory halts. Should the CMS be the primary means by which participants are made aware that a short selling circuit breaker has been triggered with respect to an individual security? Please explain. Should the exchanges be responsible for publishing daily lists of the individual securities subject to the restrictions of a short selling circuit breaker? What cost would be associated with dissemination of circuit breaker notifications and what entities would bear expense in upgrading systems to ensure compliance with a short selling circuit breaker? Please explain.

9. What would be the advantages and disadvantages of a short selling circuit breaker combined with a short selling halt versus those of a short selling circuit breaker combined with short sale price test restrictions? Please explain.

10. What would be the advantages and disadvantages of short selling circuit breakers in general? Please explain.

11. To what extent would market participants' ability to create short positions through the use of derivatives or other instruments undermine the effectiveness of a short selling circuit breaker? If this would occur, would it be more or less significant in the context of a short selling circuit breaker as compared to a short sale price test restriction? What effects would any increase in ''synthetic short sales'' after a circuit breaker is reached during a rapid market decline have on market volatility, liquidity, and price efficiency? Would a short selling circuit breaker create an unlinking of equity markets from derivatives market prices?

12. Would a short selling circuit breaker result in exacerbated downward pressure as the trigger was approached, creating a ''magnet effect''? Would any such ''magnet effect'' differ between a circuit breaker that when triggered imposed a short selling halt, and a circuit breaker that when triggered imposed a short sale price test restriction? Please explain and provide empirical data and analysis where appropriate to support the explanation.

13. Before determining whether to adopt a short selling circuit breaker on a permanent basis, should we adopt a rule that would apply, on a pilot basis, the operation of a short selling circuit breaker on individual securities? If so, what variation of a short selling circuit breaker should be applied on a pilot basis? Should the pilot circuit breaker when triggered result in short selling halts in individual securities, or rather should such a pilot circuit breaker impose short sale price test restrictions

on individual securities? Please explain. Such an approach would allow us to study the effects on, among other things, market volatility, price efficiency, and liquidity during the recent changes in market conditions. What would be other benefits of taking this approach? What would be the costs of taking this approach? Would the costs associated with programming systems to apply a short selling circuit breaker on specified individual securities outweigh any benefits of having a pilot? If we were to take this approach, how long would it take to program systems to apply a short selling circuit breaker in specified individual securities? Would it take longer or be more difficult to implement a short selling circuit breaker that when triggered imposed short selling halts? Would it take longer or be more difficult to implement a short selling circuit breaker that when triggered imposed short sale price test restrictions? Please explain. Similar to the Pilot conducted immediately prior to the elimination of former Rule 10a–1, the securities that could be subject to the pilot could be comprised of a subset of the Russell 3000 index, or such other securities as necessary or appropriate in the public interest and consistent with the protection of investors after giving due consideration to the security's liquidity, volatility, market depth and trading market. Would it be appropriate for such a pilot to be comprised of a subset of the Russell 3000 index? How should the securities that would comprise a pilot be selected? Please explain the reasons for any suggested selection method. Such a pilot could remain in effect for one or two years. Would a one or two year pilot be an appropriate period of time? If so, why? If not, why not? Please provide specific reasons to support any views in favor of establishing another time period.

14. In connection with the Pilot conducted immediately prior to our elimination of former Rule 10a–1, SROs publicly released transactional short selling data so that data would be available to the public to encourage independent researchers to study the Pilot. If we were to adopt a rule that would apply, on a pilot basis, a short selling circuit breaker on individual securities, we would expect to make information obtained during any such pilot publicly available. In addition, we would expect SROs to again make data available to the public during any such pilot. Would there be any costs associated with making short selling data available to the public during the period of a pilot? What would be the benefits of making such data available to the public?

15. The proposed circuit breaker rules would not be triggered if there is a severe decline in the price of any NMS security within 30 minutes of the end of regular trading hours on any trading day. As noted above, former NYSE Rule 80A provided that a circuit breaker would not trigger program trading restrictions after 3:25 p.m., or approximately 35 minutes before the close. Is 30 minutes an appropriate time to limit the proposed circuit breaker rules? Is 35 minutes more appropriate? At what point during the trading day would it be too disruptive to implement a circuit breaker rule? Is a 30 minute period sufficient to avoid major disruptions to the markets? Do thinly traded NMS securities raise additional concerns? If a circuit breaker would otherwise be triggered toward the end of the trading day, what alternative short sale restriction would be helpful in addressing a severe market decline in the price of a particular NMS security? Please provide any data if available.

16. Should a circuit breaker be based on an intra-day decline from that day's opening price? For instance, should the circuit breaker be triggered by a 10% decline from the opening price during regular trading hours?

17. As proposed, the proposed circuit breaker rules, once triggered, would impose a short selling halt or a short sale price test restriction in the individual security until the close of the consolidated system.[296] Should the short selling halt or short sale price test restriction conclude at the end of regular trading hours (which are from 9:30 a.m. until 4 p.m. EST)?[297] Should we consider extending the short selling halt or short sale price test, when triggered, for a longer period of time? Should the halt be extended until the opening of regular trading hours on the next trading day? Please explain.

Questions Regarding Proposed Circuit Breaker Halt Rule

1. If a short selling circuit breaker was to be imposed, should short selling in individual securities be halted entirely during a period of severe decline in the price of the security? If so, why? If not, why not? Please explain.

2. If short selling should be halted during periods of severe decline in the price of an individual security, how should the decline be measured? Should the decline be tied to a market index or the price of an individual security? Should illiquidity in the market for an individual security be a factor in measuring a decline in the price of a security for purposes of determining whether to halt short selling in a particular security? Please explain.

3. If short selling should be halted during periods of severe decline in the price of an individual security, on what price should the decline be based? Should the decline be based on the previous day's closing price? If the decline is measured by the prior day's closing price at the end of regular trading hours, should it be based on the closing price reported in the consolidated system, or some other widely disseminated price? Please explain.

4. The proposed circuit breaker rules would impose a short sale halt on any security that declines in price 10% or more relative to the prior day's closing price for that security. We note that a low trigger level may result in more securities becoming subject to a halt or some securities becoming subject to a halt more frequently, resulting in potential increases in costs, decreases in liquidity, and decreases in market quality for the affected security. Also, the impact of a lower trigger level may be greater for thinly traded securities and higher volatility securities than for other securities. However, if a high level is established, more securities may face severe price declines for longer periods before a halt is imposed. This also may affect thinly traded securities more than other securities. Is 10% an appropriate trigger for a circuit breaker rule that results in short sale halt? If not, at what level should a halt take place? Should the trigger be different for thinly traded or higher volatility securities? Should the halt take place after a 10% decline, or a higher/lower level? Should the initial halt take place after a 5% decline, or a 15% decline, or a 20% decline, or some other decline? Please explain. Should the decline be measured as a percentage of the individual security's price or should another value be used? Please explain. For example, should the decline measurement for the circuit breaker threshold be based on the dollar amount of the decline, i.e., $5? If so, how should the thresholds be determined in relation to the price level of the individual stock? Should the percentage decline be linked to the stock's price level such that stocks with lower prices must experience a greater percentage decline before the circuit breaker is triggered? If so, what thresholds are appropriate? Please explain. If the percentage decline is linked to price level, what additional

[296] *See* Sections III.A.3 and III.B.3. discussing the after-hours trading with regard to the proposed modified uptick rule and the proposed uptick rule, respectively.

[297] *See supra* note 274.

operational burdens would be experienced if stock values were required to be continuously monitored due to frequent fluctuation? Please explain. What costs and benefits may accrue from having the decline based on a dollar amount rather than a value derived from a percentage of the share value? What potential problems or benefits may arise from pegging a short selling circuit breaker threshold to a decline in a stock's dollar amount? Please explain.

5. The proposed circuit breaker halt rule would impose a short selling halt for the trading day following the triggering of the circuit breaker. Is this an appropriate length of time? If so, why? If not, why not, and how long should the halt persist? Should the length of the halt vary depending on the time during the day that the circuit breaker is triggered? [298] We note that increasing the length of a halt to an additional day or multiple additional days may increase costs, reduce market quality, and reduce liquidity in that security. This may affect thinly traded securities and higher volatility securities more than other securities. However, decreasing the period of time to less than a trading day, such as limiting the halt to an hour or a few hours following the trigger, may reduce the effectiveness of the halt. Would it be more beneficial for a 10% intraday decline to trigger a periodic halt in short selling rather than a halt for the trading day? Should it result in a multiple day halt in short selling? Please explain. How disruptive to normal trading would a multiple day halt be compared to a halt for one trading day? If short selling is halted after the circuit breaker is triggered in the wake of a 10% intraday decline, and the value of the stock continues to decline throughout the day to the point where it is down 20% at closing, should short selling be allowed to resume the following trading day? If so, why? If not, why not? Please explain. Should a 20% or greater intraday decline result in a halt on short selling for multiple trading days? For example, would it be appropriate for a 20% intraday decline on the day the circuit breaker is triggered to result in a 3-day halt in short selling, a 5-day halt in short selling, or a 10-day halt in short selling? Specifically, what length of a short selling halt would be appropriate for the various levels of decline in excess of 10%? Should volatility of the individual security be considered? Please explain.

6. Should different stocks be subject to different levels of decline before the circuit breaker is triggered? For example, should a higher trigger level apply to more liquid stocks than to less liquid stocks? Should different trigger levels be based on market capitalization or volatility of individual securities? If so, what parameters should apply and what criteria should be used to determine those parameters? Please explain.

7. Would a circuit breaker that when triggered halts short selling in a particular security result in increased selling pressure by short sellers in anticipation of the halt for securities experiencing large price declines? Please explain and provide data and analysis to support the explanation. What provisions, if any, would facilitate an orderly re-entry of a security after a halt on short selling? Please explain.

8. What benefits would be associated with a short selling circuit breaker that when triggered imposes short selling halts? Could such a short selling halt help stabilize the market for the individual security? If so, why? If not, why not? Could the short selling halt benefit investors by allowing the market to ''cool off'' with respect to that individual security? Please explain. Could a temporary short selling halt imposed by a circuit breaker result in an increase in investor confidence? Please explain.

9. What costs would be associated with implementing a short selling circuit breaker for individual securities that when triggered imposed a halt on short selling? Please explain. What would it cost to update systems in a manner necessary to ensure compliance with such a circuit breaker? Would the expenditure necessary to ensure compliance be primarily an ''up-front'' cost? Would the expenditure necessary to ensure compliance require long-term investment? Please explain. What technological challenges would be encountered in updating systems to ensure compliance with a short selling circuit breaker that applied to individual securities and when triggered imposed halts on short selling? Please explain. How long would it take to update systems in a manner that ensured compliance with such a short selling circuit breaker? Please explain.

10. Should a short selling circuit breaker that when triggered imposed a halt on short selling contain exceptions? If so, why? If not, why not? Please explain. Should the circuit breaker contain an exception for bona fide market making? If so, why? If not, why not? Should such an exception apply to: Registered market makers, block positioners, other market makers obligated to quote in the over-the-counter market, in each case that are selling short the individual securities subject to the short selling halt? If so, why? If not, why not, and what entities should be excepted under a bona fide market making exception? Should the circuit breaker provide an exception that would allow short sales that occur as a result of automatic exercise or assignment of an equity option held prior to the effectiveness of the short selling halt due to expiration of the option? If so, why? If not, why not? Please explain. Should the circuit breaker contain an exception for options market makers selling short as part of bona fide market making and hedging activities related directly to bona fide market making in derivatives on the individual security subject to the halt? If so, why? If not, why not? Please explain. The circuit breaker halt rule as proposed includes an exception for hedging activity by market makers engaged in bona fide market making, but it does not provide an exception for hedging of convertible securities or for convertible arbitrage activities by persons who are not market makers engaged in bona fide market making activities at the time of the short sale. Should we consider exceptions for convertible arbitrage and/or the hedging of convertible securities by persons who are not market makers engaged in bona fide market making? Would such exceptions reduce the effectiveness of the rule? How often would this exception be used? Please explain and provide empirical data to support explanations/analyses.

11. What other exceptions should be considered or included in such a circuit breaker? Please explain.

12. What would be an appropriate implementation period for the circuit breaker? Would a three-month implementation period be appropriate for a circuit breaker that when triggered imposed short selling halts on individual securities? Is more or less time necessary? Please explain.

13. Should the exception for owned securities be limited to Rule 144 securities, similar to the Short Sale Ban, or expanded to include other securities that a seller is deemed to own but are not included under Rule 200(b) of Regulation SHO?

14. We are proposing to include an exception for marker makers, including over-the-counter market makers, that sell short as part of bona fide market making and hedging activity directly related to bona fide market making in

[298] *See* 1998 Release *supra* note 230 and accompanying text (discussing that SRO Circuit Breaker rules vary the length of the trading halt depending on the time of day the halt is triggered and the amount of the decline triggering the halt).

derivative securities based on covered securities or exchange traded funds and exchange traded notes of which covered securities are a component. Similar to the Short Sale Ban, should we also provide that this exception would not apply to any market maker that knows that the customer's or counterparty's transaction would result in the customer or counterparty establishing or increasing an economic net short position (*i.e.,* through actual positions, derivatives, or otherwise) in a covered security? Do the same concerns apply for a short sale halt that would only be in place for one trading day? What if the proposed circuit breaker halt rule prohibits short selling in a particular security for longer than one trading day when triggered? How long of a period would necessitate including such a provision?

15. Should the proposed circuit breaker halt rule be adopted in addition to a permanent, marketwide short sale price test restriction rule? Thus, while a short sale price test restriction rule would be in place as a permanent, marketwide rule, a circuit breaker would also trigger a short selling halt in any security that suffers a severe price decline.

16. Should the proposed circuit breaker halt rule apply to non-NMS securities? Would a 10% trigger level cause some non-NMS securities to be halted too frequently? Should we consider a different trigger for non-NMS securities?

17. As an alternative to a circuit breaker rule that prohibits short selling at any price after the trigger price is reached, should we consider instead a price limit rule that would prohibit short selling in a particular NMS security at a price lower than 10% below the prior day's close? Unlike a circuit breaker rule, a price limit rule would continue to allow short selling at prices above the limit price after the limit has been reached. Would 10% be the appropriate limit? Should it be higher or lower? Please explain.

18. We propose including an exception for sales of securities that the seller is deemed to own pursuant to Rule 200(b) of Regulation SHO because these are sales of owned securities. Are broker-dealers able to identify short sales as sales of Rule 200(b) owned securities on an intra-day basis so that the exception would be useful when a circuit breaker is triggered?

Questions Regarding Circuit Breaker Price Test Rule

1. Should a short selling circuit breaker impose a short sale price test restriction on individual equity securities, rather than halt short selling for individual securities when triggered? For example, following a 10% decline in a security's price, as measured from the prior day's closing price, should a circuit breaker result in a temporary short sale price test restriction in the form of the proposed modified uptick rule or the proposed uptick rule? Please explain.

2. Should we consider a circuit breaker rule that, when triggered, would prohibit short selling in a particular NMS security on a downbid unless the short sale is effected at a price that is more than 10% greater than the prior day's closing price? Would 10% be an appropriate requirement? Should it be higher or lower? Should we have different percentages for different types of securities (*e.g.,* based on volatility, market capitalization, volume traded)? Please explain.

3. The proposed circuit breaker rules would impose a short sale price test on any security that suffers a decline in price of 10% or more relative to the prior day's closing price for that security. We note that a low trigger level may result in more securities becoming subject to a short sale price test or some securities becoming subject to a short sale price test more frequently, resulting in potential increases in costs, decreases in liquidity, and decreases in market quality for the affected security. Also, the impact of a lower trigger level may be greater for thinly traded securities or higher volatility securities than for other securities. However, if a high level is established, more securities may face severe price declines for longer periods before the short sale price test is imposed. This also may affect thinly traded securities more than other securities. Unlike a circuit breaker that results in a halt, however, a circuit breaker that results in a short sale price test would not prohibit short selling but would restrict short selling to a rising market. Also, the short sale price test would be limited to a trading unit increment, which may result in fewer costs and reduced loss of liquidity than a short sale halt. Is 10% an appropriate trigger for a circuit breaker rule that results in short sale price test? If not, at what percentage trigger level should short sale price test restrictions be imposed? Would a 10% trigger level be appropriate? Would a higher or lower trigger level be appropriate? Should the trigger be different for thinly traded or higher volatility stocks? Should we consider market capitalization in determining different trigger levels?

4. What short sale price test restrictions would be most appropriate in combination with a short selling circuit breaker? Should the circuit breaker when triggered result in a short sale price test based on the national best bid, similar to the proposed modified uptick rule? Please explain. Should the circuit breaker when triggered result in a short sale price test based on the last sale price, similar to the proposed uptick rule? Please explain. Should the circuit breaker when triggered result in a short sale price test that requires short sale orders to be initiated only at a price above the highest prevailing national best bid by posting a quote for a short sale order above the national bid? If so, why? If not, why not? If the circuit breaker when triggered results in a short sale price test restriction based on the national best bid (the proposed modified uptick rule), should short selling be restricted to a specific increment above the current national best bid, such as one cent above the national best bid? Or should a higher or lower increment apply? Please explain. If a specific increment is suggested, what impact would such an increment have on short selling in the individual security? Please explain. What increment, if any, would be tantamount to a halt on short selling during the period in which the circuit breaker is in effect? Please explain and provide empirical data and analysis in support of any arguments and/or analyses.

5. The proposed circuit breaker halt rule would impose a short sale price test for the trading day following the triggering of the circuit breaker. Is this an appropriate length of time? If so, why? If not, why not, and how long should the short sale price test persist? We note that increasing the length of a halt to an additional days or multiple additional days may increase costs, reduce market quality, and reduce liquidity in that security. This may affect thinly traded securities or higher volatility securities more than other securities. However, decreasing the period of time to less than the trading day, such as limiting the short sale price test to an hour or a few hours following the trigger, may reduce the effectiveness of the short sale price test. Would it be more beneficial for a 10% intraday decline to trigger a short sale price test in short selling for a few hours rather than for the trading day? Should it result in a multiple day short sale price test? Please explain. How disruptive to normal trading would a multiple day short sale price test be compared to a halt for one trading day? If short selling is restricted by a price test after the circuit breaker is triggered in the wake of a 10% intraday decline, and the value of the stock continues to decline

throughout the day to the point where it is down 20% at closing, should short selling be allowed to resume the following trading day? If so, why? If not, why not? Please explain. Should a 20% or greater intraday decline result in a short sale price test for multiple trading days? For example, would it be appropriate for a 20% intraday decline on the day the circuit breaker is triggered to result in a 3-day price test restriction in short selling, a 5-day restriction on short selling, or a 10-day restriction on short selling? Specifically, what length of a restriction would be appropriate for the various levels of decline in excess of 10%? Should we consider a different period for higher volatility stocks? Should we consider market capitalization in determining different trigger levels? Please explain.

6. What benefits would be associated with a short selling circuit breaker that when triggered imposed short sale price test restrictions? Could the short sale price test restrictions help stabilize the market for the individual security? If so, why? If not, why not? Could the short sale price test restrictions benefit investors by allowing the market to ''cool off'' with respect to that individual security? Please explain. Could a circuit breaker that when triggered imposes short sale price test restrictions result in an increase in investor confidence? Please explain.

7. What are the benefits, if any, of a circuit breaker that when triggered imposes short sale price test restrictions, versus a permanent, market-wide short sale price test such as the modified uptick rule or the proposed uptick rule? Please explain and support explanations with data and analysis where appropriate.

8. What costs would be associated with implementing a short selling circuit breaker that when triggered imposed short sale price test restrictions? Please explain. What would be the degree of financial expenditure involved in updating systems in a manner necessary to ensure compliance with such a circuit breaker? Would the expenditure necessary to ensure compliance be primarily an ''up-front'' cost? Would the expenditure necessary to ensure compliance require long-term investment? Please explain. How would the costs of a circuit breaker that when triggered imposes short sale price test restrictions compare with the costs of a permanent short sale price test such as the proposed modified uptick rule or the proposed uptick rule? Please explain.

9. What technological challenges would be encountered in updating systems to ensure compliance with a short selling circuit breaker that when triggered imposed short sale price test restrictions on individual securities? Please explain. How long would it take to update systems in a manner that ensured compliance? Please explain. Would a short selling circuit breaker that when triggered imposed short sale price test restrictions impede the efficient functioning of the equity markets? If so, why? If not, why not? Please explain. Are there any other operational challenges that may arise from implementing a short selling circuit breaker that when triggered imposed short sale price test restrictions? Please explain. Would the operational challenges presented impede the effectiveness of such a short selling circuit breaker? Please explain.

10. Are there other short sale price test restrictions that should be considered in combination with a short selling circuit breaker? Please explain.

11. Should a circuit breaker that when triggered imposed short sale price test restrictions include exceptions? Please explain. If such a circuit breaker is based on the proposed modified uptick rule, should it contain the same exceptions as those contemplated in the proposed modified uptick rule? If so, why? If not, why not? If other or different exceptions are warranted for such a circuit breaker, what should they be? Please explain. If a circuit breaker is based on the proposed uptick rule, should it contain the same exceptions as those contemplated in the proposed uptick rule? If so, why? If not, why not? If other or different exceptions are warranted for such a circuit breaker, what should they be? Please explain.

12. Should a circuit breaker that when triggered imposed short sale price test restrictions contain a general market maker exception? If so, why? If not, why not? If so, should the market maker exemption be limited to registered market makers, exchange-based market makers, or apply to over-the-counter market makers as well? Should upstairs customer facilitation be exempted from a short selling circuit breaker? Should parties involved in delta neutral hedging be excepted from a short selling circuit breaker? Should parties involved with index arbitrage be excepted from a short selling circuit breaker that when triggered imposed short sale price test restrictions? What other exceptions may be appropriate? Please explain.

13. What implementation period would be necessary for the circuit breaker? Would a three month implementation period be appropriate for a circuit breaker that when triggered imposed short sale price test restrictions on individual securities? Is more or less time necessary? Please explain.

14. One commenter suggested a circuit breaker that, when triggered, would prohibit any person from selling short except at an upbid.[299] Should a circuit breaker that triggers a bid-based price restriction for a particular security be expanded to prohibit short sales both on a downbid and at the bid? Thus, once triggered, short sales in the particular security could only be executed or displayed, or effected, at an upbid. We note that such a rule would be stricter than the proposed circuit breaker modified uptick rule, which would permit short sales at the bid unless the bid is on a downbid. As a result, this proposal may result in additional costs, reduce liquidity, and reduce market quality. However, this proposed rule may also establish a longer ''break'' before short selling resumes. Would it be appropriate to change the proposed circuit breaker modified uptick rule to require that, following the trigger of the circuit breaker, short sales could only be effected at an upbid? Please explain why this may be more appropriate.

15. Would it be more appropriate for the resulting price test to be based on a policies and procedures rule or a straight prohibition? For instance, a circuit breaker that triggers a policies and procedures rule would require trading centers to incur immediate upfront costs to establish policies and procedures that would be implemented and enforced once a circuit breaker is triggered for a particular security. Would a circuit breaker that triggers a straight prohibition incur fewer costs? Please explain.

V. Marking

Rule 200(g) of Regulation SHO provides that a broker-dealer must mark all sell orders of any security as ''long'' or ''short.''[300] As initially adopted, Regulation SHO included an additional marking requirement of ''short exempt'' applicable to short sale orders if the seller was ''relying on an exception from the tick test of 17 CFR 240.10a–1, or any short sale price test of any exchange or national securities association.''[301] We adopted amendments to Rule 200(g) of Regulation SHO to remove the ''short exempt'' marking requirement in conjunction with our elimination of former Rule 10a–1.[302]

[299] *See* National Exchanges Letter, *supra* note 63.

[300] *See* 17 CFR 242.200(g).

[301] *See* 2004 Regulation SHO Adopting Release, 69 FR 48008.

[302] *See* 2007 Price Test Adopting Release, 72 FR 36348.

In conjunction with the proposed amendments to Rule 201 of Regulation SHO to add a short sale price test or a circuit breaker rule, we are proposing to amend Rule 200(g) of Regulation SHO to again impose a ''short exempt'' marking requirement. Specifically, proposed Rule 200(g) would provide that ''[a] broker or dealer must mark all sell orders of any equity security as ''long,'' ''short,'' or ''short exempt.'' [303]

In addition, proposed Rule 200(g)(2) of the proposed modified uptick rule would provide that a sale order shall be marked ''short exempt'' only if the provisions of paragraph (c) or (d) of proposed Rule 201 are met.[304] This ''short exempt'' marking requirement would provide a record that a broker-dealer is availing itself of the provisions of paragraph (c) or (d) of the proposed modified uptick rule.

Proposed Rule 200(g)(2) of the proposed uptick rule or the proposed circuit breaker rules would provide that a sale order shall be marked ''short exempt'' only if the seller is relying on an exception from the price test of § 242.201.[305] This ''short exempt'' marking requirement would provide a record that short sellers are availing themselves of the various exceptions to the application of the restrictions of the proposed uptick rule.[306]

The records provided pursuant to the ''short exempt'' marking requirements of proposed Rule 200(g) of the proposed short sale price test rules and the proposed circuit breaker rules would aid surveillance by SROs and the Commission for compliance with the provisions of either of those short sale price test restrictions. In addition, if the Commission were to adopt a policies and procedures approach, such as is proposed in conjunction with the proposed modified uptick rule, the proposed ''short exempt'' marking requirement would provide an indication to a trading center regarding whether it must execute or display a short sale order with regard to whether the short sale order is at a down-bid price.

If we were to adopt the proposed ''short exempt'' marking requirement of proposed Rule 200(g) of the proposed short sale price test rules or the proposed circuit breaker rules, we are proposing an implementation period under which market participants would have to comply with this requirement three months following the effective date of the proposed marking requirement. We believe that this proposed implementation period would provide market participants with sufficient time in which to modify their systems and procedures in order to comply with the proposed marking requirements. We realize, however, that a shorter or longer implementation period may be manageable or preferable. Thus, we seek specific comment as to what length of implementation period would be necessary or appropriate, and why, such that market participants would be able to meet the proposed marking requirements, if adopted.

Request for Comment

We seek comment generally on all aspects of the proposed amendment to Rule 200(g) of Regulation SHO. In addition, we seek comment on the following:

1. What type of costs, if any, would be associated with requiring sell orders to be marked ''short exempt'' when relying on an exception under proposed Rule 201? What types of costs, if any, would be associated with not requiring sell orders to be marked ''short exempt'' when relying on an exception under proposed Rule 201?

2. Should the proposed rule require a broker-dealer marking a sell order ''short exempt'' to identify the specific provision on which the broker-dealer is relying in marking the order ''short exempt''? If not, why not?

3. What would be a sufficient implementation period for making any systems changes necessary to allow sell orders to be marked ''short exempt''?

4. Please describe any anticipated difficulties in complying with a ''short exempt'' marking requirement.

5. The ''short exempt'' marking has historically been used only for short sales that are excepted from a short sale price test. For instance, the ''short exempt'' marking was not available for short sales that were excepted from the Regulation SHO locate requirement of Rule 203(b). We are, however, proposing to require short sales that are excepted from the proposed circuit breaker halt rule, when triggered, to be marked ''short exempt.'' Would a ''short exempt'' marking be needed for the proposed circuit break rules if circuit breakers operate in place of short sale price test restrictions?

VI. Overseas Transactions

In connection with former Rule 10a–1, the Commission consistently took the position that the rule applied to trades in securities subject to that rule where the trade was ''agreed to'' in the U.S., but booked overseas.[307] In addition, in the 2004 Regulation SHO Adopting Release we stated that any broker-dealer using the United States jurisdictional means to effect short sales in securities traded in the United States would be subject to Regulation SHO, regardless of whether the broker-dealer is registered with the Commission or relying on an exemption from registration.[308] For example, a U.S. money manager decides to sell a block of 500,000 shares in an NMS stock. The money manager negotiates a price with a U.S. broker-dealer, who sends the order ticket to its foreign trading desk for execution. In our view, this trade occurred in the United States as much as if the trade had been executed by the broker-dealer

[303] *See* proposed Rule 200(g) of the proposed modified uptick rule and of the proposed uptick rule.

[304] *See* proposed Rule 200(g)(2) of the proposed modified uptick rule.

[305] *See* Proposed Rule 200(g)(2).

[306] The improper marking of a short sale order as ''short exempt'' by the broker-dealer would be a violation of proposed Rule 200(g)(2) and Exchange Act Section 10(a). In addition, the improper marking of a short sale order as ''short exempt'' could, in some circumstances, result in liability under the antifraud provisions of the federal securities laws; the liability of the broker-dealer that marked the order, and of the trading center that displayed or executed the order, would turn on whether those entities acted with the mental state required under the applicable antifraud provisions.

[307] *See* Securities Exchange Act Release No. 27938 (Apr. 23, 1990), 55 FR 17949 (Apr. 30, 1990) (stating that the no-action position exempting certain index arbitrage sales from former Rule 10a–1 would not apply to an index arbitrage position that was established in an offshore transaction unless the holder acquired the securities from a seller that acted in compliance with former Rule 10a–1 or other comparable provision of foreign law). *See also* Securities Exchange Act Release No. 21958 (Apr. 18, 1985), 50 FR 16302 (Apr. 25, 1985) at n. 48 (stating that, ''Rule 10a–1 does not contain any exemption for short sales effected in international markets.''). The question of whether a particular transaction negotiated in the U.S. but nominally executed abroad by a foreign affiliate is a domestic trade for U.S. regulatory purposes was also addressed in the Commission's Order concerning Wunsch Auction Systems, Inc. (WASI). The Commission stated its belief that ''trades negotiated in the U.S. on a U.S. exchange are domestic, not foreign trades. The fact that the trade may be time-stamped in London for purposes of avoiding an SRO rule does not in our view affect the obligation of WASI and BT Brokerage to maintain a complete record of such trades and report them as U.S. trades to U.S. regulatory and self-regulatory authorities and, where applicable, to U.S. reporting systems.'' *See* Securities Exchange Act Release No. 28899 (Feb. 20, 1991), 56 FR 8377 (Feb. 28, 1991). In what is commonly referred to as the ''fax market,'' a U.S. broker-dealer acting as principal for its customer negotiates and agrees to the terms of a trade in the U.S., but transmits or faxes the terms overseas to be ''printed'' on the books of a foreign office. This practice of ''booking'' trades overseas was analyzed in depth in the Division of Market Regulation's Market 2000 Report. In the Report, the Division estimated that at that time approximately 7 million shares a day in NYSE stocks were faxed overseas, and many of these trades were nominally ''executed'' in the London over-the-counter market. *See* Division of Market Regulation, SEC, Market 2000: An Examination of Current Equity Market Developments (Jan. 1994), Study VII, p. 2.

[308] *See* 2004 Regulation SHO Adopting Release, 69 FR at 48104, n. 54.

at a U.S. trading desk. Under either the proposed short sale price test rules or the proposed circuit breaker rules, if the short sale is agreed to in the U.S., it must be effected in accordance with the requirements of those proposed rules, unless otherwise excepted.

Request for Comment

1. Would the proposed modified uptick rule, proposed uptick rule, or circuit breaker rules, if adopted, result in sellers transacting short sales in foreign markets where they would not be subject to a short sale price test rather than in U.S. markets? If so, please explain.

2. For short sales agreed to in the United States and executed overseas, would the time the short sale is agreed to in the U.S. be the appropriate time to be used to establish the price against which the proposed uptick rule, proposed modified uptick rule, or circuit breaker rule, would be determined?

3. Please identify any challenges or difficulties that could arise in applying the proposed modified uptick rule or proposed uptick rule to short sales agreed to in the United States and executed overseas?

4. Would the proposed modified uptick rule, proposed uptick rule, circuit breaker proposals, or any other restriction on short sales, be easier to implement and enforce for short sales agreed to in the United States but executed overseas? Please explain.

5. What would be the costs and benefits of applying the proposed modified uptick rule, proposed uptick rule, the alternative circuit breaker rules, or any other restriction on short sales to short sales agreed to in the United States and executed overseas?

VII. Exemptive Procedures

The proposed alternative short sale price test rules and the alternative circuit breaker rules would establish procedures for the Commission, upon written request or its own motion, to grant an exemption from the rules' provisions, either unconditionally or on specified terms and conditions, if the Commission determines that such exemption is necessary or appropriate in the public interest and is consistent with the protection of investors.[309] Pursuant to this provision, we would consider and act upon appropriate requests for relief from the proposed short sale price tests' provisions and the proposed short sale circuit breakers' provisions, if adopted, and would consider the particular facts and circumstances relevant to each such request and any appropriate conditions to be imposed as part of the exemption. We solicit comment regarding including a provision for exemptive procedures in the proposed short sale price test rules and the proposed circuit breaker rules.

VIII. Paperwork Reduction Act

A. Background

Certain provisions of the proposed amendments to Regulation SHO would impose new ''collection of information'' requirements within the meaning of the Paperwork Reduction Act of 1995 (''PRA'').[310] We have submitted the collection of information to OMB for review and approval in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number. OMB has not yet assigned a control number to the new collection of information.

We are proposing amendments to Rules 201 and 200(g) of Regulation SHO under the Exchange Act. The proposed amendments to Rule 201 include two alternative price tests that would impose restrictions on the prices at which certain securities would be able to be sold short.[311] The first alternative short sale price test would be a proposed modified uptick rule. The second alternative short sale price test would be a proposed uptick rule. We are also proposing alternative circuit breaker rules that would establish limitations on short selling in a particular security during severe market declines in the price of that security.[312] The first alternative circuit breaker rule would be the proposed circuit breaker halt rule. The second alternative circuit breaker rule would be the proposed circuit breaker modified uptick rule. The third alternative circuit breaker rule would be the proposed circuit breaker uptick rule. In addition, we are proposing to amend Rule 200(g) of Regulation SHO to impose a ''short exempt'' marking requirement and to also require that a broker-dealer mark a sell order ''short exempt'' only if the provisions in proposed Rule 201(c) or (d) of the proposed modified uptick rule (or the proposed circuit breaker modified uptick rule) are met, or if a seller is relying on an exception in proposed Rule 201(c) of the proposed uptick rule (or the proposed circuit breaker uptick rule), or if a seller is relying on an exception in proposed Rule 201(c) of the proposed circuit breaker halt rule.[313]

B. Summary

As detailed below, several provisions under the proposed amendments to Regulation SHO would impose a new ''collection of information'' within the meaning of the PRA.

1. Policies and Procedures Requirement Under Proposed Modified Uptick Rule

The proposed modified uptick rule would impose a new ''collection of information'' within the meaning of the PRA.[314] Under the proposed modified uptick rule, a trading center would be required to have written policies and procedures reasonably designed to prevent the execution or display of a short sale order of a covered security at a down-bid price.[315] In addition, a trading center would be required to have policies and procedures reasonably designed to permit the execution or display of a short sale order of a covered security marked ''short exempt'' without regard to whether the order is at a down-bid price.[316] Thus, upon acceptance of a short sale order, a trading center's policies and procedures would have to be reasonably designed to permit the trading center to be able to determine whether or not the short sale order is priced in accordance with the provisions of proposed Rule 201(b)(1) and to recognize when an order is marked ''short exempt'' such that the trading center's policies and procedures do not prevent the execution or display of such orders on a down-bid price.[317]

At a minimum, a trading center's policies and procedures would need to enable a trading center to monitor, on a real-time basis, the national best bid,

[309] *See* proposed Rule 201(e) of the proposed uptick rule; proposed Rule 201(f) of the proposed modified uptick rule; proposed Rule 201(g) of the proposed circuit breaker halt rule and proposed circuit breaker uptick rule; and proposed Rule 201(h) of the proposed circuit breaker modified uptick rule.

[310] 44 U.S.C. 3501 *et seq.*

[311] *See* proposed Rule 201.

[312] *See* proposed Rule 201.

[313] *See* proposed Rules 200(g) and 200(g)(2).

[314] The discussion of the PRA as it applies to the proposed modified uptick rule applies equally to the proposed circuit breaker modified uptick rule.

[315] Proposed Rule 201(b)(1). A ''down bid'' is defined as ''a price that is less than the current national best bid or, if the last differently priced national best bid was greater than the current national best bid, a price that is less than or equal to the current national best bid.'' Proposed Rule 201(a)(2).

[316] *See* proposed Rule 201(b)(1)(ii). *See also* Section V, above, regarding the proposed ''short exempt'' marking requirement.

[317] *See* proposed Rule 200(g)(2). The broker-dealer marking the order ''short exempt'' would have responsibility for being able to identify on which provision to the proposed modified uptick rule it was relying in marking the order ''short exempt.''

and whether the current national best bid is an up- or down-bid from the last differently priced national best bid, so as to determine the price at which the trading center may execute or display a short sale order. As mentioned above, a trading center would need to have policies and procedures governing how to recognize and handle orders that a trading center receives as marked ''short exempt'' pursuant to proposed Rule 200(g)(2).[318] A trading center's policies and procedures also would be required to address latencies in obtaining data regarding the national best bid. In addition, to the extent such latencies occur, a trading center would be required to implement reasonable steps in its policies and procedures to monitor such latencies on a continuing basis and take appropriate steps to address a problem should one develop.

A trading center would also need to take such steps as would be necessary to enable it to enforce its policies and procedures effectively. As part of its written policies and procedures, a trading center also would be required to regularly surveil to ascertain the effectiveness of its policies and procedures and take prompt remedial steps.[319] The nature and extent of the policies and procedures that a trading center would be required to establish to comply with these requirements would depend upon the type, size, and nature of the trading center.

2. Identification of Short Sale Orders and Policies and Procedures Requirement Under the Proposed ''Broker-Dealer'' and ''Riskless Principal'' Provisions

The proposed modified uptick rule contains a ''broker-dealer'' provision that would require a new ''collection of information'' under the PRA. Proposed Rule 201(c)(1) provides that a broker dealer may mark a short sale order of a covered security ''short exempt'' if a broker-dealer that submits a short sale order to a trading center has identified that the short sale order is not on a down-bid price at the time of submission of the order to the trading center.[320] This provision would require a new ''collection of information'' in that a broker-dealer marking an order ''short exempt'' under proposed Rule 201(c)(1) must identify both a short sale order as priced in accordance with the requirements of proposed Rule 201(c)(1) and establish, maintain, and enforce written policies and procedures reasonably designed to prevent the incorrect identification of orders as being priced in accordance with the requirements of proposed Rule 201(c)(1).[321]

While the proposed uptick rule itself does not contain a ''collection of information'' requirement within the meaning of the PRA, the proposed uptick rule does contain a ''riskless principal'' exception that would require a new ''collection of information'' under the PRA.[322] The proposed modified uptick rule also contains a ''riskless principal'' provision that would require a new ''collection of information'' under the PRA. Specifically, proposed Rule 201(d)(6) of the proposed modified uptick rule and Rule 201(c)(9) of the proposed uptick rule would allow a broker-dealer to mark short sale orders of a covered security ''short exempt'' where a broker-dealer is facilitating customer buy orders or sell orders where the customer is net long, and the broker-dealer is net short but is effecting the sale as riskless principal, provided certain conditions are satisfied.[323]

Proposed Rules 201(d)(6) of the proposed modified uptick rule and 201(c)(9) of the proposed uptick rule would require a new ''collection of information'' in that each would require a broker-dealer marking an order ''short exempt'' under these provisions to have written policies and procedures in place to assure that, at a minimum, the customer order was received prior to the offsetting transaction; the offsetting transaction is allocated to a riskless principal account within 60 seconds of execution; and that it has supervisory systems in place to produce records that enable the broker-dealer to accurately and readily reconstruct, in a time-sequenced manner, all orders on which the broker-dealer relies pursuant to this provision.[324]

3. Proposed Marking Requirements

While the current marking requirements in Rule 200(g) of Regulation SHO, which require broker-dealers to mark all sell orders of any equity security as either ''long'' or ''short,''[325] would remain in effect, proposed Rule 200(g) would add a new marking requirement of ''short exempt.''[326] In addition, the proposed amendments to Rule 200(g)(2) would require that a broker-dealer mark a sell order ''short exempt'' only if the provisions in paragraph (c) or (d) of the proposed modified uptick rule (or paragraph (c) or (d) of the proposed circuit breaker modified uptick rule) are met, or if the seller is relying on an exception in paragraph (c) of the proposed uptick rule (or paragraph (c) of the proposed circuit breaker uptick rule), or if the seller is relying on an exception in paragraph (c) of the proposed circuit breaker halt rule.[327] The proposed ''short exempt'' marking requirements would impose a new ''collection of information.''

C. Proposed Use of Information

1. Policies and Procedures Requirement Under Proposed Modified Uptick Rule

The information that would be collected under the proposed modified uptick rule's written policies and procedures requirement would help ensure that the trading center does not execute or display any impermissibly priced short sale orders, unless an order is marked ''short exempt'' in accordance with the rule's requirements. This written policies and procedures requirement would also provide trading centers with flexibility in determining how to comply with the requirements of the proposed modified uptick rule. The information collected also would aid the Commission and SROs that regulate trading centers in monitoring compliance with the price test's requirements. It also would aid trading centers and broker-dealers in complying with the rule's requirements.

[318] *Id.*

[319] This provision would reinforce the ongoing maintenance and enforcement requirements of proposed Rule 201(b)(1) by explicitly assigning an affirmative responsibility to trading centers to surveil to ascertain the effectiveness of their policies and procedures. *See* proposed Rule 201(b)(2). We note that Rule 611(a)(2) of Regulation NMS contains a similar provision for trading centers. *See* 17 CFR 242.611(a)(2).

[320] *See* proposed Rule 201(c)(1).

[321] *See* proposed Rule 201(c)(1). As part of its written policies and procedures, a broker-dealer also would be required to regularly surveil to ascertain the effectiveness of its policies and procedures and take prompt remedial steps. *See* proposed Rule 201(c)(2). This provision is intended to reinforce the ongoing maintenance and enforcement requirements of the provision contained in proposed Rule 201(c)(1) by explicitly assigning an affirmative responsibility to broker-dealers to surveil to ascertain the effectiveness of their policies and procedures. *See id.*

[322] The discussion of the PRA as it applies to the proposed uptick rule applies equally to the proposed circuit breaker uptick rule.

[323] *See* proposed Rule 201(d)(6). As a result, a trading center's policies and procedures would need to be reasonably designed to permit the execution or display of such orders without regard to whether the order is at a down-bid price. *See* proposed Rule 201(b)(1)(ii).

[324] *See* proposed Rule 201(c)(9) of the proposed uptick rule and Rule 201(d)(6) of the proposed modified uptick rule.

[325] 17 CFR 242.200(g).

[326] *See* proposed Rule 200(g). *See also* Section V above discussing proposed Rule 200(g).

[327] *See* proposed Rule 200(g)(2).

2. Identification of Short Sale Orders and Policies and Procedures Requirement Under the Proposed ''Broker-Dealer'' and ''Riskless Principal'' Provisions

Proposed Rule 201(c)(1) of the proposed modified uptick rule would include a ''broker-dealer'' provision that would permit a broker-dealer to mark a short sale order in a covered security ''short exempt'' if the broker-dealer has identified the order as not being at a down-bid price at the time of submission of the order to the trading center. This provision would include a policies and procedures requirement that would be designed to help prevent incorrect identification of orders for purposes of the proposed modified uptick rule's broker-dealer provision.

Moreover, the information collection under the written policies and procedures requirement in the ''riskless principal'' exception in proposed Rule 201(c)(9) of the proposed uptick rule and the ''riskless principal'' provision in proposed Rule 201(d)(6) of the proposed modified uptick rule would help assure that broker-dealers comply with the requirements of these proposed provisions. The information collected would also enable the Commission and SROs to examine for compliance with the requirements of these proposed provisions.

3. Proposed Marking Requirements

Proposed Rule 200(g) would impose a ''short exempt'' marking requirement.[328] In addition, proposed Rule 200(g)(2) would require that a sale order be marked ''short exempt'' only if the provisions in paragraph (c) or (d) of the proposed modified uptick rule (or paragraph (c) or (d) of the proposed circuit breaker modified uptick rule) are met,[329] or if the seller is relying on an exception in paragraph (c) of the proposed uptick rule (or paragraph (c) of the proposed circuit breaker uptick rule),[330] or if the seller is relying on an exception in paragraph (c) of the proposed circuit breaker halt rule.[331] The purpose of the information collected would be to enable the Commission and SROs to monitor whether a person entering a sell order covered by the proposed amendments to Rule 201 is acting in accordance with one of the provisions contained in paragraph (c) or (d) of the proposed modified uptick rule (or paragraph (c) or (d) of the proposed circuit breaker modified uptick rule), or if the seller is relying on an exception in paragraph (c) of the proposed uptick rule (or paragraph (c) of the proposed circuit breaker uptick rule), or if the seller is relying on an exception in paragraph (c) of the proposed circuit breaker halt rule. In particular, the ''short exempt'' marking requirement would provide a record that would aid in surveillance for compliance with the provisions of proposed Rule 201. It also would provide an indication to a trading center regarding whether or not it must execute or display a short sale order in accordance with the price test restrictions of the proposed modified uptick rule (or the proposed circuit breaker modified uptick rule). It also would help a trading center determine whether its policies and procedures were reasonable and whether its surveillance was effective.

D. Respondents

As discussed below, the Commission has considered each of the following respondents for the purposes of calculating the reporting burdens under the proposed amendments to Rules 200(g) and 201 of Regulation SHO. The Commission requests comment on the accuracy of these figures.

1. Policies and Procedures Requirement Under Proposed Modified Uptick Rule

The proposed modified uptick rule would require each trading center to establish, maintain, and enforce written policies and procedures reasonably designed to prevent the execution or display of a short sale order at a down-bid price.[332] A ''trading center'' is defined as ''a national securities exchange or national securities association that operates an SRO trading facility, an alternative trading system, an exchange market maker, an OTC market maker, or any other broker-dealer that executes orders internally by trading as principal or crossing orders as agent.''[333] Because the proposed modified uptick rule would apply to any trading center that executes or displays a short sale order in a covered security, the proposed modified uptick rule would apply to 10 registered national securities exchanges that trade NMS stocks and one national securities association (or ''SRO trading centers''),[334] and approximately 372 broker-dealers (including ATSs) registered with the Commission (or ''non-SRO trading centers'').[335]

2. Identification of Short Sale Orders and Policies and Procedures Requirements Under the Proposed ''Broker-Dealer'' and ''Riskless Principal'' Provisions

The collection of information that would be required in the proposed ''broker-dealer'' provision in proposed Rule 201(c)(1) of the proposed modified uptick rule, the ''riskless principal'' provision in proposed Rule 201(d)(6) of the proposed modified uptick rule, and the ''riskless principal'' exception in proposed Rule 201(c)(9) of the proposed uptick rule would apply to all the 5,561[336] registered brokers-dealers submitting short sale orders in reliance on these proposed provisions.

3. Proposed Marking Requirements

The collection of information that would be required pursuant to the proposed ''short exempt'' marking requirements would apply to all the 5,561[337] registered brokers-dealers submitting short sale orders marked ''short exempt'' in accordance with the provisions contained in paragraph (c) or (d) of the proposed modified uptick rule (or paragraph (c) or (d) of the proposed

[328] *See* proposed Rule 200(g).

[329] *See* proposed Rule 200(g)(2) of the proposed modified uptick rule (and the proposed circuit breaker modified uptick rule). Paragraphs (c) and (d) of the proposed modified uptick rule (and the proposed circuit breaker modified uptick rule) set forth when a broker-dealer may mark a short sale order ''short exempt.'' *See* proposed Rules 201(c) and (d).

[330] *See* proposed Rule 200(g)(2) of the proposed uptick rule (and the proposed circuit breaker uptick rule). Paragraph (c) of the proposed uptick rule (and paragraph (c) of the proposed circuit breaker uptick rule) sets forth when a broker-dealer may mark a short sale order ''short exempt'' in accordance with the proposed uptick rule (or the proposed circuit breaker uptick rule). *See* proposed Rule 201(c).

[331] *See* proposed Rule 200(g)(2) of the proposed circuit breaker halt rule. Paragraph (c) of the proposed circuit breaker halt rule sets forth when a broker-dealer may mark a short sale order ''short exempt'' in accordance with the proposed circuit breaker halt rule. *See* proposed Rule 201(c).

[332] *See* proposed Rule 201(b)(1).

[333] *See* 17 CFR 242.600(b)(78).

[334] There are 10 national securities exchanges (BX, BATS, CBOE, CHX, ISE, NASDAQ, NSX, NYSE, NYSE Amex, and NYSE Arca) and one national securities association (FINRA) that operate an SRO trading facility for NMS stocks and thus would be subject to the Rule.

[335] This number includes the approximately 325 firms that were registered equity market makers or specialists at year-end 2007 (this number was derived from annual FOCUS reports and discussion with SRO staff), as well as the 47 ATSs that operate trading systems that trade NMS stocks. The Commission believes it is reasonable to estimate that in general, firms that are block positioners—*i.e.,* firms that are in the business of executing orders internally—are the same firms that are registered market makers (for instance, they may be registered as a market maker in one or more Nasdaq stocks and carry on a block positioner business in exchange-listed stocks), especially given the amount of capital necessary to carry on such a business.

[336] This number is based on OEA's review of 2007 FOCUS Report filings reflecting registered broker-dealers, including introducing broker-dealers. This number does not include broker-dealers that are delinquent on FOCUS Report filings.

[337] *See id.*

circuit breaker modified uptick rule), or in reliance on an exception contained in paragraph (c) of the proposed uptick rule (or paragraph (c) of the proposed circuit breaker uptick rule), or in reliance on an exception contained in paragraph (c) of the proposed circuit breaker halt rule.

E. Total Annual Reporting and Recordkeeping Burdens

1. Policies and Procedures Requirement under Proposed Modified Uptick Rule

The proposed modified uptick rule would require each trading center to establish, maintain, and enforce written policies and procedures reasonably designed to prevent the execution or display of a short sale order of a covered security at a down-bid price.[338] In addition, a trading center would need to have policies and procedures reasonably designed to permit the execution or display of a short sale order of a covered security marked ''short exempt'' without regard to whether the order is at a down-bid price.[339] Thus, trading centers would be required to develop written policies and procedures reasonably designed to permit the trading center to be able to determine whether or not the short sale order is priced in accordance with the provisions of proposed Rule 201(b)(1) and to recognize when an order is marked ''short exempt'' such that the trading center's policies and procedures do not prevent the execution or display of such orders on a down-bid price in accordance with proposed Rule 201(b)(1)(ii).[340] A trading center's policies and procedures would not, however, have to include mechanisms to determine on which provision a broker-dealer is relying in marking an order ''short exempt'' in accordance with paragraph (c) or (d) of the proposed modified uptick rule.

Although the exact nature and extent of the policies and procedures that a trading center would be required to establish likely would vary depending upon the nature of the trading center (*e.g.,* SRO vs. non-SRO, full service broker-dealer vs. market maker), we preliminarily estimate that it initially would take an SRO trading center approximately 220 hours[341] of legal, compliance, information technology and business operations personnel time,[342] and a non-SRO trading center approximately 160 hours of legal, compliance, information technology and business operations personnel time,[343] to develop the required policies and procedures.

In addition to this estimate (of 220 hours for SRO respondents and 160 hours for non-SRO respondents), we expect that SRO and non-SRO respondents may incur one-time external costs for outsourced legal services. While we recognize that the amount of legal outsourcing utilized to help establish written policies and procedures may vary widely from entity to entity, we preliminarily estimate that on average, each trading center would outsource 50 hours of legal time in order to establish policies and procedures in accordance with the proposed amendments.[344]

We estimate that there would be an initial one-time burden of 220 (not including the outsourced 50 hours of legal time) burden hours per SRO trading center or 2,420 hours,[345] and 160 (not including the outsourced 50 hours of legal time) burden hours per non-SRO trading center[346] or 59,520 hours, for a total of 61,940 burden hours to establish the required written policies and procedures.[347] We estimate a cost of approximately $7,660,000 for both SRO and non-SRO trading centers resulting from outsourced legal work.[348]

Once a trading center has established the required written policies and procedures, we preliminarily estimate that it would take the average SRO and non-SRO trading center each approximately two hours per month of ongoing internal legal time and three hours of ongoing internal compliance time to ensure that its written policies and procedures are up-to-date and remain in compliance with the proposed amendments to Rule 201, or a total of 60 hours annually per respondent.[349] In addition, we preliminarily estimate that it would take the average SRO and non-SRO trading center each approximately 16 hours per month of ongoing compliance time, 8 hours per month of ongoing information technology time, and 4 hours per month of ongoing legal time associated with ongoing monitoring and surveillance for and enforcement of trading in compliance with the proposed modified uptick rule, or a total of 336 hours annually per respondent.[350]

As mentioned above, we realize that the exact nature and extent of the policies and procedures that a trading

[338] *See* proposed Rule 201(b)(1). This would include a trading center taking such steps as would be necessary to enable it to enforce its policies and procedures effectively, including the proposed requirement to regularly surveil to ascertain the effectiveness of its policies and procedures and taking prompt remedial steps. *See* proposed Rule 201(b)(2).

[339] *See* proposed Rule 201(b)(1)(ii). *See also* Sections III.A. and V, above, discussing short sale orders marked ''short exempt.''

[340] *See* proposed Rule 201(b)(1)(ii).

[341] For purposes of this Release, we are basing our estimates on the burden hour estimates provided in connection with the adoption of Regulation NMS because the policies and procedures developed in connection with that Regulation's order protection rule are in many ways similar to what a trading center would need to do to comply with the proposed modified uptick rule. *See* Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496 (June 29, 2005). We note, however, that these estimates may be on the high end because trading centers have already had to establish similar policies and procedures to comply with Regulation NMS.

[342] Based on experience and estimates provided in connection with Regulation NMS, we anticipate that of the 220 hours we preliminarily estimate would be spent to establish the required policies and procedures, 70 hours would be spent by legal personnel, 105 hours would be spent by compliance personnel, 20 hours would be spent by information technology personnel and 25 hours would be spent by business operations personnel of the SRO trading center.

[343] Based on experience and the estimates provided in connection with Regulation NMS, we anticipate that of the 160 hours we preliminarily estimate would be spent to establish policies and procedures, 37 hours would be spent by legal personnel, 77 hours would be spent by compliance personnel, 23 hours would be spent by information technology personnel and 23 hours would be spent by business operations personnel of the non-SRO trading center.

[344] As discussed above, we base our burden estimate of 50 hours of outsourced legal time on the burden estimate used for Regulation NMS because the policies and procedures developed in connection with that Regulation's order protection rule are in many ways similar to what a trading center would need to do to comply with the proposed modified uptick rule.

[345] The estimated 2,420 burden hours necessary for SRO trading centers to establish policies and procedures are calculated by multiplying 11 times 220 hours (11 × 220 hours = 2,420 hours).

[346] The estimated 59,520 burden hours necessary for non-SRO trading centers to establish policies and procedures are calculated by multiplying 372 times 160 hours (372 × 160 hours = 59,520 hours).

[347] Proposed Rule 201(b)(1). Proposed Rule 201(b)(1) requires that ''A trading center shall establish, maintain, and enforce written policies and procedures reasonably designed to prevent the execution or display of a short sale order at a down-bid price.''

[348] This figure was calculated as follows: (50 legal hours × $400 × 11 SRO trading centers) + (50 legal hours × $400 × 372 non-SRO trading centers) = $7,660,000. Based on industry sources, OEA estimates that the average hourly rate for outsourced legal services in the securities industry is $400.

[349] This figure was calculated as follows: (2 legal hours × 12 months) + (3 compliance hours × 12 months) = 60 hours annually per respondent. As discussed above, this burden estimate of 60 hours is based on experience and what was estimated for Regulation NMS to ensure that written policies and procedures were up-to-date and remained in compliance.

[350] This figure was calculated as follows: (16 compliance hours × 12 months) + (8 information technology hours × 12 months) + (4 legal hours × 12 months) = 336 hours annually per respondent. As discussed above, this preliminary burden estimate of 336 hours is based on experience and what was estimated for Regulation NMS regarding similarly required ongoing monitoring and surveillance for and enforcement of trading in compliance with that regulation's policies and procedures requirement.

center would be required to establish likely would vary depending upon the type, size, and nature of the trading center. Thus, while we have based our burden estimates, in part, on the burden estimates provided in connection with the adoption of Regulation NMS, we note that these estimates may be on the high end because trading centers have already had to establish policies and procedures in connection with that Regulation's order protection rule, which could help form the basis for the policies and procedures for the proposed modified uptick rule. We realize, however, that these estimates may be on the low end for smaller trading centers with less familiarity with having had to establish policies and procedures in connection with Regulation NMS's order protection rule. Thus, we seek specific comment as to whether the proposed burden estimates are appropriate or whether such estimates should be increased or reduced, and for which entities. If they should be increased or decreased, please address by how much, in order to be able to comply with the proposed modified uptick rule's required policies and procedures, if adopted.

2. Identification of Short Sale Orders and Policies and Procedures Requirements Under the Proposed ''Broker-Dealer'' and ''Riskless Principal'' Provisions

To rely on the proposed modified uptick rule's Rule 201(c)(1) ''broker-dealer'' provision, a broker-dealer marking a short sale order in a covered security ''short exempt'' under proposed Rule 201(c)(1) must identify the order as not being a down-bid price at the time the order is submitted to the trading center and must establish, maintain, and enforce written policies and procedures that are reasonably designed to prevent the incorrect identification of orders as not being submitted to the trading center at a down-bid price.[351] At a minimum, the broker-dealer's policies and procedures would need to be reasonably designed to enable a broker-dealer to monitor, on a real-time basis, the national best bid, and whether the current national best bid is an up- or down-bid from the last differently priced national best bid, so as to determine the price at which the broker-dealer may submit a short sale order to a trading center in compliance with the requirements of proposed Rule 201(c)(1). In addition, a broker-dealer would also need to take such steps as would be necessary to enable it to enforce its policies and procedures effectively.[352]

To rely on proposed Rule 201(d)(6)'s ''riskless principal'' provision under the proposed modified uptick rule or Rule 201(c)(9)'s ''riskless principal'' exception to the proposed uptick rule, a broker-dealer would be required to have written policies and procedures in place to assure that, at a minimum, the customer order was received prior to the offsetting transaction and that it has supervisory systems in place to produce records that enable the broker-dealer to accurately and readily reconstruct, in a time-sequenced manner, all orders on which a broker-dealer relies pursuant to these provisions.

Although the exact nature and extent of the required policies and procedures that a broker-dealer would be required to establish under the ''broker-dealer'' or the ''riskless principal'' provisions likely would vary depending upon the nature of the broker-dealer (*e.g.,* full service broker-dealer vs. market maker), we preliminarily estimate that it initially would take a broker-dealer approximately 160 hours[353] of legal, compliance, information technology and business operations personnel time,[354] to develop the required policies and procedures. In addition to this estimate of 160 hours, we expect that broker-dealers may incur one-time external costs for outsourced legal services. While we recognize that the amount of legal outsourcing utilized to help establish written policies and procedures may vary widely from entity to entity, we preliminarily estimate that on average, each broker-dealer would outsource 50 hours[355] of legal time in order to establish policies and procedures in accordance with the ''broker-dealer'' provision in proposed Rule 201(c)(1) of the proposed modified uptick rule, the ''riskless principal'' exception in 201(c)(9) of the proposed uptick rule, and the ''riskless principal'' provision in 201(d)(6) of the proposed modified uptick rule.

We preliminarily estimate that there would be an initial one-time burden of 160 burden hours per broker-dealer or 889,760 hours[356] to establish policies and procedures that would be required to rely on the proposed modified uptick rule's ''broker-dealer'' provision in proposed Rule 201(c)(1), the ''riskless principal'' exception in Rule 201(c)(9) of the proposed uptick rule, or the ''riskless principal'' provision in 201(d)(6) of the proposed modified uptick rule. We preliminarily estimate a cost of approximately $111,220,000 for broker-dealers resulting from outsourced legal work.[357]

Once a broker-dealer has established written policies and procedures that would be required so that it could rely on proposed 201(c)(1) of the proposed modified uptick rule, 201(c)(9) of the proposed uptick rule, or 201(d)(6) of the proposed modified uptick rule, we preliminarily estimate that it would take the average broker-dealer approximately two hours per month of internal legal time and three hours of internal compliance time to ensure that its written policies and procedures are up-to-date and remain in compliance with proposed 201(c)(1) of the proposed modified uptick rule, 201(c)(9) of the proposed uptick rule, or 201(d)(6) of the proposed modified uptick rule, or a total of 60 hours annually per respondent.[358]

[351] *See* proposed Rule 201(c)(1).

[352] This would include the proposed requirement that broker-dealer regularly surveil to ascertain the effectiveness of its policies and procedures and taking prompt remedial steps. *See* proposed Rule 201(c)(2).

[353] We base this estimate of 160 hours on the estimated burden hours we preliminarily believe it would take a non-SRO trading center (which would include broker-dealers) to develop similarly required policies and procedures, since the policies and procedures required under the proposed broker-dealer provisions would be similar to those required for non-SRO trading centers in complying with paragraph (b) of the proposed modified uptick rule.

[354] Based on experience and the estimates provided in connection with Regulation NMS, we anticipate that of the 160 hours we estimate would be spent to establish policies and procedures; 37 hours would be spent by legal personnel, 77 hours would be spent by compliance personnel, 23 hours would be spent by information technology personnel and 23 hours would be spent by business operations personnel of the broker-dealer.

[355] As discussed above, we base our burden estimate of 50 hours of outsourced legal time on the burden estimate used for Regulation NMS because the policies and procedures developed in connection with that Regulation's order protection rule are in many ways similar to what a broker-dealer would need to do to comply with the policies and procedures required under the proposed broker-dealer provision of the proposed modified uptick rule.

[356] As discussed above, we base this estimate of 160 hours on the estimated burden hours we preliminarily believe it would take a non-SRO trading center (which would include broker-dealers) to develop similarly required policies and procedures since the policies and procedures required under the proposed broker-dealer provisions would be similar to those required for non-SRO trading centers in complying with paragraph (b) of the proposed modified uptick rule.

The estimated 889,760 burden hours necessary for a broker-dealer to establish policies and procedures are calculated by multiplying 5,561 times 160 hours (5,561 × 160 hours = 889,760 hours).

[357] This figure was calculated as follows: (50 legal hours × $400 × 5,561 broker-dealers) = $111,220,000. Based on industry sources, OEA estimates that the average hourly rate for outsourced legal services in the securities industry is $400.

[358] This figure was calculated as follows: (2 legal hours × 12 months) + (3 compliance hours × 12 months). As discussed above, this burden estimate of 60 hours is based on experience and what was

In addition, we preliminarily estimate that it would take the average broker-dealer each approximately 16 hours per month of ongoing compliance time, 8 hours per month of ongoing information technology time, and 4 hours per month of ongoing legal time associated with ongoing monitoring and surveillance for and enforcement of trading in compliance with the proposed modified uptick rule, or a total of 336 hours annually per respondent.[359]

As mentioned above, we realize that the exact nature and extent of the policies and procedures that a broker-dealer would be required to establish likely would vary depending upon the type, size, and nature of the broker-dealer. Thus, while we have based our burden estimates on the burden estimates provided in connection with the adoption of Regulation NMS with respect to non-SRO trading centers (which includes broker-dealers), we note that these estimates may be on the high end for those broker-dealers that have already had to establish policies and procedures in connection with that Regulation's order protection rule, which could help form the basis for the policies and procedures for the proposed broker-dealer provision of the modified uptick rule, or the riskless principal provisions under the proposed modified uptick rule and the proposed uptick rule. We realize, however, that these estimates may be on the low end for some broker-dealers with less familiarity with having had to establish policies and procedures in connection with Regulation NMS's order protection rule. Thus, we seek specific comment as to whether the proposed burden estimates are appropriate or whether such estimates should be increased or reduced, and for which broker-dealers. If they should be increased or decreased, please address by how much, in order to be able to comply with the proposed provisions' required policies and procedures, if adopted.

3. Proposed Marking Requirements

Proposed Rule 200(g) would impose a ''short exempt'' marking requirement.[360] In addition, proposed Rule 200(g)(2) would require a broker-dealer to mark all sell orders of a covered security ''short exempt'' only if the provisions contained in paragraph (c) or (d) of the proposed modified uptick rule (or paragraph (c) or (d) of the proposed circuit breaker modified uptick rule) are met, or if the seller is relying on one of the exceptions contained in paragraph (c) of the proposed uptick rule (or paragraph (c) of the proposed circuit breaker uptick rule), or if the seller is relying on one of the exceptions contained in paragraph (c) of the proposed circuit breaker halt rule.[361] While not all broker-dealers likely would enter sell orders in securities covered by the proposed amendments to Rules 200(g) and 201 in a manner that would subject them to this collection of information, we estimate, for purposes of the PRA, that all of the approximately 5,561 registered broker-dealers would do so.[362] For purposes of the PRA, the Commission staff has estimated that a total of approximately 12.9 billion ''short exempt'' orders would be entered annually.[363]

This would be an average of approximately 2,319,727 annual responses by each respondent.[364] Each response of marking sell orders ''short exempt'' would take approximately .000139 hours (.5 seconds) to complete.[365] We base this estimate on the fact that, in accordance with the current marking requirements of Rule 200(g) of Regulation SHO, broker-dealers are already required to mark a sell order either ''long'' or short''; the fact that most broker-dealers already have the necessary mechanisms and procedures in place and are already familiar with processes and procedures to comply with the marking requirements of Rule 200(g) of Regulation SHO; and the fact that broker-dealers would be able to continue to use the same mechanisms, processes and procedures to comply with proposed Rules 200(g) and 200(g)(2).

Thus, the total approximate estimated annual hour burden per year would be 1,793,100 burden hours (12,900,000,000 orders marked ''short exempt'' @ 0.000139 hours/order marked ''short exempt''). Our estimate for the paperwork compliance for the proposed amendments order marking requirement for each broker-dealer would be approximately 322 burden hours (2,319,727 responses @ 0.000139 hours/responses) or (a total of 1,793,100 burden hours/5,561 respondents).

F. Collection of Information Is Mandatory

1. Proposed Policies and Procedures Requirements

The collection of information that would be required under the proposed modified uptick rule's (and proposed circuit breaker modified uptick rule's) policies and procedures requirement in proposed Rule 201(b)(1) would be mandatory for trading centers executing and displaying short sale orders in covered securities. The collection of information that would be required under the proposed modified uptick rule's (and proposed circuit breaker modified uptick rule's) policies and procedures requirements in connection with the proposed broker-dealer provision in proposed Rule 201(c)(1) and the ''riskless principal'' provision in proposed Rule 201(d)(6), and the collection of information that would be required under the proposed uptick rule's (and proposed circuit breaker uptick rule's) policies and procedure requirement in connection with the proposed ''riskless principal'' exception in proposed Rule 201(c)(9) would be mandatory for broker-dealers relying on these provisions.

2. Proposed Marking Requirements

The collection of information would be mandatory for all broker-dealers submitting sell orders marked ''short exempt'' in reliance on one of the proposed provisions contained in paragraph (c) or (d) of the proposed modified uptick rule (or paragraph (c) or

estimated for a Regulation NMS respondent to ensure that its written policies and procedures were up-to-date and remained in compliance.

[359] This figure was calculated as follows: (16 compliance hours × 12 months) + (8 information technology hours × 12 months) + (4 legal hours × 12 months) = 336 hours annually per respondent. As discussed above, this preliminary burden estimate of 336 hours is based on experience and what was estimated for Regulation NMS for similarly required ongoing monitoring and surveillance for and enforcement of trading in compliance with that regulation's policies and procedures requirement.

[360] *See* proposed Rule 200(g).

[361] *See* proposed Rule 200(g)(2).

[362] We also note that, because the proposed circuit breaker halt rule, if adopted, would not be in place at all times or for all securities and because there would be fewer exceptions that would be available and they would apply only when the restrictions of the proposed circuit breaker halt rule are triggered, the frequency and, therefore, the estimate burden of marking ''short exempt'' would be expected to be lower under the proposed circuit breaker halt rule.

[363] There are approximately 45.4 billion short sale orders entered annually. OEA calculates that there were about 263 million short sale trades during August 2008 for Amex, FINRA, Nasdaq, NYSEArca, and NYSE market centers. We gross up 263 million by 14.4 which is the ratio of orders to trades. The ratio is derived from Rule 605 reports from the three largest market centers during August 2008. This yields 3.8 billion short sale orders during August 2008 or an annualized figure of 45.4 billion. OEA believes that August 2008 data is representative of a normal month of trading. We estimate that approximately 28.5% of short sale orders are short exempt using Nasdaq short sale data from January to April 2005. We multiply 45.4 billion times 0.285 to obtain our estimate of 12.9 billion short exempt orders.

[364] This figure was calculated as follows: 12.9 billion ''short exempt'' orders divided by 5,561 broker-dealers.

[365] This estimate is based on the same time estimate for marking sell orders ''long'' or ''short'' under current Rule 200(g) under Regulation SHO. *See* 2004 Regulation SHO Adopting Release, 69 FR at 48023; *see also* 2003 Regulation SHO Proposing Release, 68 FR at 63000 n. 232.

(d) of the proposed circuit breaker modified uptick rule), or in reliance on an exception in paragraph (c) of the proposed uptick rule (or paragraph (c) of the proposed circuit breaker uptick rule), or in reliance on an exception in paragraph (c) of the proposed circuit breaker halt rule.

G. Confidentiality

1. Proposed Policies and Procedures Requirements

We expect that the information collected pursuant to the proposed modified uptick rule's (and the proposed circuit breaker modified uptick rule's) required policies and procedures would be communicated to the members, subscribers, and employees (as applicable) of all trading centers. To the extent this information is made available to the Commission, it would not be kept confidential. The information collected pursuant to the proposed modified uptick rule's (or proposed circuit breaker modified uptick rule's) ''broker-dealer'' provision and the ''riskless principal'' provisions under the proposed short sale price tests (or under the proposed circuit breaker price tests) would be retained and would be available to the Commission and SRO examiners upon request, but not subject to public availability.

2. Proposed Marking Requirements

The information collected pursuant to the ''short exempt'' marking requirements in proposed Rules 200(g) and 200(g)(2) would be submitted to trading centers and would be available to the Commission and SRO examiners upon request.

H. Record Retention Period

1. Proposed Policies and Procedures Requirements

Any records generated in connection with the proposed short sale price tests' requirements to establish written policies and procedures and the proposed circuit breaker rules would be required to be preserved in accordance with, and for the periods specified in, Exchange Act Rules 17a–1 for SRO trading centers and 17a–4(e)(7) for non-SRO trading centers.

2. Proposed Marking Requirements

The proposed amendments to Rule 200(g) and 200(g)(2) do not contain any new record retention requirements. All registered broker-dealers that would be subject to the proposed amendments are currently required to retain records in accordance with Rule 17a–4(e)(7) of the Exchange Act.[366]

I. Request for Comment

We invite comment on these estimates. Pursuant to 44 U.S.C. 3506(c)(2)(B), we request comment in order to: (a) Evaluate whether the collection of information is necessary for the proper performance of our functions, including whether the information will have practical utility; (b) evaluate the accuracy of our estimate of the burden of the collection of information; (c) determine whether there are ways to enhance the quality, utility and clarity of the information to be collected; and (d) evaluate whether there are ways to minimize the burden of the collection of information on those who respond, including through the use of automated collection techniques or other forms of information technology.

Persons submitting comments on the collection of information requirements should direct them to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should also send a copy of their comments to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549–1090, with reference to File No. [S7–08–09]. Requests for materials submitted to OMB by the Commission with regard to this collection of information should be in writing, with reference to File No. [S7–08–09], and be submitted to the Securities and Exchange Commission, Records Management, 100 F Street, NE., Washington, DC 20549. As OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication.

IX. Cost-Benefit Analysis

We are sensitive to the costs and benefits of our rules. We request comment on the costs and benefits associated with the proposed amendments. In particular, we request comment on the potential costs for any modification to both computer systems and surveillance mechanisms and for information gathering, management, and recordkeeping systems or procedures, as well as any potential benefits resulting from the proposed amendments for registrants, issuers, investors, brokers or dealers, other securities industry professionals, regulators, and others. We also request comment as to the extent to which placing price restrictions on short selling could impact or lessen some of the benefits of legitimate short selling or could lead to a decrease in market efficiency, price discovery, or liquidity. Commenters should provide analysis and data to support their views on the costs and benefits associated with the proposed amendments to Rules 200(g) and 201.

A. Benefits

As discussed above, we believe it is appropriate at this time to examine and seek comment on whether to restore short sale price test restrictions or adopt circuit breaker rules in light of the extreme market conditions that we are currently facing and the resulting deterioration in investor confidence.

The proposed amendments to Rule 201 include two alternative price tests that would place restrictions on the prices at which certain securities would be able to be sold short.[367] The first test would be the proposed modified uptick rule that would be based on the national best bid and would require trading centers to have policies and procedures reasonably designed to prevent the execution or display of short sales at impermissible prices. The second test would be the proposed uptick rule that would be based on the last sale price, similar to the tick test under former Rule 10a–1, and would prohibit any person from effecting short sales at impermissible prices.

We are also proposing circuit breaker rules that would establish limitations on short selling in a particular security during severe market declines in the price of that security.[368] The proposed circuit breaker halt rule, when triggered by a severe price decline in a particular security, would temporarily prohibit any person from selling short that security during the effectiveness of the circuit breaker.[369] The proposed circuit breaker modified uptick rule, when triggered by a severe market decline in a particular security, would temporarily impose the proposed modified uptick rule, as described in detail above, for that security. The proposed circuit breaker uptick rule, when triggered by a severe market decline in a particular security, would temporarily impose the

[366] 17 CFR 240.17a–4.

[367] *See* proposed Rule 201.

[368] *See* proposed Rule 201.

[369] The proposed circuit breaker halt rule could be imposed in place of, or in addition to, a short sale price rule.

proposed uptick rule, as described in detail above, for that security.[370]

In addition, we are proposing amendments to Rule 200(g) of Regulation SHO to impose a ''short exempt'' marking requirement and to Rule 200(g)(2) of Regulation SHO to require broker-dealers to mark a sell order ''short exempt'' only if the provisions in paragraph (c) or (d) of the proposed modified uptick rule (or paragraph (c) or (d) of the proposed circuit breaker modified uptick rule) are met, or if the seller is relying on an exception in paragraph (c) of the proposed uptick rule (or paragraph (c) of the proposed circuit breaker uptick rule), or if the seller is relying on an exception in paragraph (c) of the proposed circuit breaker halt rule.

1. Proposed Short Sale Price Tests

The two alternative short sale price tests proposed would be designed to allow relatively unrestricted short selling in an advancing market. In addition, the proposed short sale price tests would be designed to restrict short selling at successively lower prices and, thereby, help prevent short selling, including potentially abusive or manipulative short selling, from being used as a tool for driving the market down or from being used to accelerate a declining market by exhausting all remaining bids at one price level, causing successively lower prices to be established by long sellers. Further, the two alternative short sale price tests would be designed to help restore investor confidence in the securities markets.[371]

In particular, by requiring trading centers to have policies and procedures reasonably designed to prevent the execution or display of short sale orders at a down-bid price, unless the order is marked ''short exempt,'' and by requiring them to regularly surveil to ascertain the effectiveness of the policies and procedures and to take prompt remedial action to remedy deficiencies in such policies and procedures, the proposed modified uptick rule might help to prevent short selling, including potentially abusive or manipulative short selling, from driving the market down and from being used as a tool to accelerate a declining market. Similarly, for the proposed uptick rule, by prohibiting the execution of short sale orders below the last sale price, unless an exception applies, the alternative proposed uptick rule might also help to prevent short selling, including potentially abusive or manipulative short selling, from being used as a tool to drive the market down and accelerate a declining market.

At the same time, the proposed short sale price tests might help to preserve instant execution and liquidity, by allowing relatively unrestricted short selling in an advancing market. As discussed above, one of the benefits of legitimate short selling is that it may provide market liquidity by, for example, adding to the selling interest of stock available to purchasers, and, when sellers are covering their short sales, adding to the buying interest of stock available to sellers.

In seeking to advance these goals, the proposed short sale price tests might help address the erosion of investor confidence in our markets. Bolstering investor confidence in the markets should help to encourage investors to be more willing to invest in the market, thus adding depth and liquidity to the markets. Moreover, as discussed above, prior research on the uptick rule indicates that price test restrictions might help improve market depth, especially at the offer, and could also dampen intraday volatility.[372] For example, as discussed above, OEA found that price test restrictions resulted in an increase in the quote depths.[373]

2. Proposed Circuit Breaker Halt Rule

The proposed circuit breaker halt rule, when triggered by a severe price decline in a particular security, would temporarily prohibit any person from selling short a particular NMS stock during a severe decline in the price of that security.[374] By targeting only those securities that experience severe intraday declines, the proposed circuit breaker halt rule would be designed to help prevent short selling, including potentially abusive or manipulative short selling, from being used to drive the price of a security down, or to accelerate the decline in the price of those securities when needed most. By applying only to those individual securities that are facing a severe intraday decline in share price, the proposed circuit breaker halt rule might benefit the market as a narrowly tailored response to extraordinary circumstances.[375] It also might benefit the market by allowing participants an opportunity to reevaluate circumstances and respond to volatility.[376]

We believe that the proposed circuit breaker halt rule also would be narrowly tailored to help restore investor confidence and stabilize the market for individual securities during times of substantial uncertainty.[377] By halting short selling for the remainder of the trading day following a significant decline in a security's price, we believe the proposed circuit breaker halt rule might provide sufficient time to re-establish equilibrium between buying and selling interests in the individual security in an orderly fashion. It might also help to ensure that market participants have a reasonable opportunity to become aware of, and respond to, a significant decline in a security's price. By providing a pause in short selling resulting from a significant decline in the price of an individual equity security, we believe the proposed circuit breaker halt rule might provide a measure of stability to the markets. We believe that the proposed circuit breaker halt rule might help to restore investor confidence during times of substantial uncertainty.

Moreover, unlike the proposed short sale price test restrictions, the proposed circuit breaker halt rule would halt all short selling for an individual security only for a specified period of time. Thus, the proposed circuit breaker halt rule would also be narrowly tailored to help address the issue of ''bear raids'' while limiting the potential negative market quality impact that may arise from the proposed short sale price test restrictions.[378]

3. Proposed Circuit Breaker Price Test Rules

The alternative proposed circuit breaker price test rules, when triggered by a severe market decline in a particular security, would temporarily impose either the proposed circuit breaker modified uptick rule or the proposed circuit breaker uptick rule, as each rule is described above, for a particular NMS stock during a severe market decline in that security, and would remain in place for the remainder of the trading day.[379]

[370] A circuit breaker that triggers a short sale price test rule would be adopted in place of a short sale price test rule.

[371] *See, e.g., supra* note 56 (citing comment letters suggesting that reinstatement of short price test restrictions in some format would help restore investor confidence in the market).

[372] *See supra* note 35 (referencing OEA Staff's Summary Pilot Report, at 55 n. 61–63 and supporting text).

[373] *See supra* note 37 (referencing OEA Staff's Summary Pilot Report, at 55 n. 61–63 and supporting text).

[374] *See* proposed Rule 201.

[375] *See* 1998 Release, 63 FR 18477 (April 15, 1998) *supra* note 230.

[376] *See id.*

[377] *See id.*

[378] *See* 1998 Release, 63 FR 18477.

[379] For instance, a circuit breaker resulting in the proposed modified uptick rule would require that trading centers implement and enforce policies and procedures reasonably designed to prevent short

Continued

We believe that the proposed circuit breaker price test rules would be narrowly tailored to help restore investor confidence and stabilize the market for individual securities. The proposed circuit breaker price test rules might also help prevent short selling, including potentially abusive or manipulative short selling, from being used as a tool for driving the market down or from being used to accelerate a declining market by exhausting all remaining bids at one price level, causing successively lower prices to be established by long sellers. Further, we also believe that allowing short selling to continue with price test restrictions once a circuit breaker is triggered might also have less impact on legitimate short selling and normal market activity including price discovery and the provision of liquidity than a circuit breaker that halts short selling. To that end, we believe that the proposed circuit breaker price test rules might also alleviate some concerns over the possibility of artificial downward pressure that might arise from a ''magnet effect'' prior to reaching the trigger threshold.[380]

4. Proposed Marking Requirements

In addition, the ''short exempt'' marking requirements under Rule 200(g)(2) would provide a record that a broker-dealer is availing itself of the provisions of paragraph (c) or (d) of the proposed modified uptick rule (or paragraphs (c) or (d) of the proposed circuit breaker modified uptick rule), or that short sellers are availing themselves of the various exceptions to the application of the restrictions of the proposed uptick rule (or the proposed circuit breaker uptick rule), or that short sellers are availing themselves of the various exceptions to the application of the proposed circuit breaker halt rule. Thus, the records created pursuant to the ''short exempt'' marking requirements of proposed Rule 200(g) of the proposed short sale price test rules or the proposed circuit breaker rules would aid surveillance by SROs and the Commission for compliance with the provisions of those short sale price tests or circuit breaker rules. In addition, if the Commission were to adopt a policies and procedures approach, such as is proposed in conjunction with the proposed modified uptick rule (or proposed circuit breaker modified uptick rule), the proposed ''short exempt'' marking requirement would provide an indication to a trading center regarding whether it must execute or display a short sale order with regard to whether the short sale order is at a down-bid price.

B. Costs

1. Proposed Short Sale Price Test Restrictions

We recognize that the proposed amendments, if adopted, would impose costs on market participants to implement and assure compliance with the proposed short sale price test requirements. These costs could, in sum, increase the costs of legitimate short selling. We believe, however, that such costs might be justified by the design of the proposed short sale price tests to restrict short selling at successively lower prices and, thereby, help prevent short selling, including potentially abusive or manipulative short selling, from being used as a tool for driving the market down or from being used to accelerate a declining market by exhausting all remaining bids at one price level, causing successively lower prices to be established by long sellers. Further, by seeking to advance these goals, the proposed price test restrictions might help restore investor confidence in the securities markets.

We recognize that, to the extent that the proposed short sale price test restrictions could result in increased costs of short selling in NMS stocks, it might lessen some of the benefits of legitimate short selling and, thereby, could result in a reduction in short selling generally. Such a reduction might lead to a decrease in market efficiency and price discovery, less protection against upward stock price manipulations, a less efficient allocation of capital, an increase in trading costs, and a decrease in liquidity. Restricting short selling may also reduce ''long'' activity where it is part of the same strategy, thus adversely affecting liquidity. Thus, we believe there might be potential costs associated with the proposed short sale price tests in terms of potential impact of such price tests on quote depths, spread widths, and market liquidity.

We also believe costs might be incurred in terms of execution and pricing inefficiencies. For example, allowing all short sales to be executed or displayed at or above the best bid (or last sale price) in an advancing market, and above the best bid (or last sale price) in a declining market might slow the speed of executions and impose additional costs on market participants, including buyers.[381]

In addition, we recognize that imposing short sale price restrictions when, currently, there is an absence of any short sale price test restrictions may result in costs in terms of modifications to systems and surveillance mechanisms, as well as changes to processes and procedures. We anticipate that these changes would likely result in immediate implementation costs for trading centers and SROs and other market participants associated with reprogramming trading and surveillance systems to now account for price test restrictions based on either last sale or best bid information, as discussed in more detail below. We also believe the proposed amendments may impose costs to trading centers and SROs and other market participants related to systems changes to computer hardware and software, reprogramming costs, and surveillance and compliance costs, as well as staff time and technology resources, associated with monitoring compliance with the proposed short sale price test restrictions, as discussed below.

Moreover, imposing price test restrictions when there are currently no short sale price restrictions in place also could mean that staff (compliance personnel, associated persons, etc.) might need to be trained or re-trained regarding rules related to price test restrictions. Also, trading centers and SROs and other market participants could be required to hire additional staff (and train or re-train them) to comply with the proposed rules related to short sale price test restrictions. As such, we believe the proposed amendments, if adopted, might impose training and compliance costs for trading centers, SROs, and other market participants.

a. Proposed Modified Uptick Rule

The proposed modified uptick rule, in particular, would require each trading center to establish, maintain, and enforce written policies and procedures reasonably designed to prevent the execution or display of a short sale order at a down-bid price.[382] In addition, a trading center would be required to have policies and procedures reasonably designed to

selling at a down-bid price in a particular security, when triggered by a decline in the price of that security. Broker-dealer could mark certain short sale orders ''short-exempt'' under the conditions set forth above. A circuit breaker resulting in the proposed uptick rule would, once triggered by a decline in the price of a particular security, prohibit any person from selling short on a downtick.

[380] *See, e.g.,* letter from Credit Suisse (discussing ''magnet effect'').

[381] As discussed above, on the day the Pilot went into effect, listed Pilot securities underperformed listed control group securities by approximately 24 basis points. The Pilot and control group securities, however, had similar returns over the first six months of the Pilot. *See supra* note 36 (referencing OEA Staff's Summary Pilot Report at 8).

[382] *See* proposed Rule 201(b)(1).

permit the execution or display of a short sale order of a covered security marked ''short exempt'' without regard to whether the order is at a down-bid price.[383] A trading center's policies and procedures would not, however, have to include mechanisms to determine on which provision a broker-dealer is relying in marking an order ''short exempt'' in accordance with paragraph (c) or (d) of the proposed modified uptick rule. In addition, trading centers also would be required to surveil the effectiveness of their written policies and procedures and take prompt action to remedy any deficiencies in their policies and procedures.

As detailed in the PRA section, VIII, above, although the exact nature and extent of the required policies and procedures that a trading center would be required to establish likely would vary depending upon the nature of the trading center (*e.g.,* SRO vs. non-SRO, full service broker-dealer vs. market maker), we preliminarily estimate a total one-time initial cost of $26,393,412 [384] for all trading centers subject to the proposed modified uptick rule to establish the written policies and procedures reasonably designed to help prevent the execution or display of short sale orders not priced in accordance with the provisions of proposed Rule 201(b)(1).

Once a trading center has established written policies and procedures reasonably designed to help prevent the execution or display of a short sale order at a down-bid price, we preliminarily estimate a total annual ongoing cost of $7,119,204 [385] for all trading centers subject to the proposed modified uptick rule to ensure that their written policies and procedures are up-to-date and remain in compliance with the proposed amendments to Rule 201. In addition, with regard to ongoing monitoring for and enforcement of trading in compliance with the proposed modified uptick rule, as detailed in the PRA section, VIII, above, we preliminary believe that, once the tools necessary to carry out on-going monitoring have been put in place, a trading center would be able to incorporate ongoing monitoring and enforcement within the scope of its existing surveillance and enforcement policies and procedures without a substantial additional burden. We recognize, however, that this ongoing compliance would not be cost-free, and that trading centers would incur some additional annual costs associated with ongoing compliance, including compliance costs of reviewing transactions. We preliminarily estimate that each trading center would incur an average annual ongoing compliance cost of $102,768, for a total annual cost of $39,360,144 for all trading centers.[386]

As detailed in the PRA section, VIII, above, we realize that the exact nature and extent of the policies and procedures that a trading center would be required to establish would likely vary depending upon the type, size, and nature of the trading center. Thus, while we have based our estimates on the burden estimates provided in connection with the adoption of Regulation NMS, we note that these estimates may be on the high end because trading centers have already had to establish policies and procedures in connection with that Regulation's order protection rule, which could help form the basis for the policies and procedures for the proposed modified uptick rule. We realize, however, that these estimates may be on the low end for some trading centers. Thus, we seek specific comment as to whether these estimates are appropriate or whether such estimates should be increased or reduced and for which entities. If they should be increased or decreased, please address by how much, in order to be able to comply with the proposed modified uptick rule's required policies and procedures, if adopted.

As detailed in the PRA section, VIII, above, although the exact nature and extent of the required policies and procedures that a broker-dealer would be required to establish under the ''broker-dealer'' provision in proposed Rule 201(c)(1) of the proposed modified uptick rule, as well as under the ''riskless principal'' provision in proposed Rule 201(d)(6) of the proposed modified uptick rule and the ''riskless principal'' exception in proposed Rule 201(c)(9) of the proposed uptick rule, likely would vary depending upon the nature of the broker-dealer (*e.g.,* full service broker-dealer vs. market maker), we preliminarily estimate a total one-time initial cost of $380,266,741 for all broker-dealers relying on the broker-dealer provision in proposed Rule 201(c)(1) of the proposed modified uptick rule; the ''riskless principal'' provisions in proposed Rules 201(d)(6) of the proposed modified uptick rule; or 201(c)(9) of the proposed uptick rule, to establish the written policies and procedures reasonably designed to prevent the incorrect identification of orders as being priced in accordance with the broker-dealer provision or, in the case of the ''riskless principal'' provisions, to assure that, at a minimum, the customer order was received prior to the offsetting transaction and to assure the broker-dealer has supervisory systems in place

[383] *See* proposed Rule 201(b)(1)(ii). *See also* Sections III.A.2. and V, above, discussing short sale orders marked ''short exempt.''

[384] This figure was calculated by adding $18,733,412 and $7,660,000 (for outsourced legal work). The $18,733,412 figure was calculated as follows: (70 legal hours × $305) + (105 compliance hours × $313) + (20 information technology hours × $292) + (25 business operation hours × $273) = $66,880 per SRO × 11 SROs = $735,680 total cost for SROs; (37 legal hours × $305) + (77 compliance hours × $313) + (23 information technology hours × $292) + (23 business operation hours × $273) = $48,381 per broker-dealer × 372 broker-dealers = $17,997,732 total cost for broker-dealers; $735,680 + $17,997,732 = $18,733,412. The $7,660,000 figure for outsourced legal work was calculated as follows: (50 legal hours × $400 × 11 SROs) + (50 legal hours × $400 × 372 broker-dealers) = $7,660,000.

Based on industry sources, OEA estimates that the average hourly rate for outsourced legal services in the securities industry is $400. For in-house legal services, we estimate that the average hourly rate for an attorney in the securities industry is approximately $305 per hour. The $305/hour figure for an attorney is from SIFMA's *Management & Professional Earnings in the Securities Industry 2008,* modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead. In addition, OEA estimates that the average hourly rate for an assistant compliance director, a senior computer programmer, a senior operations manager, in the securities industry is approximately $313, $292, and $273 per hour, respectively. These figures are from SIFMA's *Management & Professional Earnings in the Securities Industry 2008,* modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

[385] This figure was calculated as follows: (2 legal hours × 12 months × $305) × (11 + 372) + (3 compliance hours × 12 months × $313) × (11 + 372) = $7,119,204.

[386] We preliminarily estimate that each trading center would incur an average annual ongoing compliance cost of $102,768 for a total annual cost of $39,360,144 for all trading centers. This figure was calculated as follows: (16 compliance hours × $313) + (8 information technology hours × $292) + (4 legal hours × $305) × 12 months = $102,768 per trading center × 383 trading centers = $39,360,144. As discussed above, we base our burden hour estimates on the estimates used for Regulation NMS because it requires similar ongoing monitoring and surveillance for and enforcement of trading in compliance with that regulation's policies and procedures requirement.

For in-house legal services, we estimate that the average hourly rate for an attorney in the securities industry is approximately $305 per hour. The $305/hour figure for an attorney is from SIFMA's *Management & Professional Earnings in the Securities Industry 2008,* modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead. In addition, OEA estimates that the average hourly rate for an assistant compliance director, a senior computer programmer, a senior operations manager, in the securities industry is approximately $313, $292, $273 per hour, respectively. These figures are from SIFMA's *Management & Professional Earnings in the Securities Industry 2008,* modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

to produce records that enable the broker-dealer to accurately and readily reconstruct, in a time-sequenced manner, all orders on which a broker-dealer relies pursuant to these provisions of the proposed price tests.[387]

Once a broker-dealer has established written policies and procedures that would be required so that it could rely on the proposed modified uptick rule's ''broker-dealer provision'' in proposed Rule 201(c)(1); the ''riskless principal'' exception in proposed Rule 201(c)(9) of the proposed uptick rule; or the ''riskless principal'' provision in proposed Rule 201(d)(6) of the proposed uptick rule, we estimate a total annual on-going cost of $103,367,868 for all broker-dealers relying on any of these three provisions to ensure that its written policies and procedures are up-to-date and remain in compliance with the proposed amendments to Rule 201.[388] In addition, with regard to ongoing monitoring for and enforcement of trading in compliance with the proposed modified uptick rule's ''broker-dealer'' provision in proposed Rule 201(c)(1), as detailed in the PRA section, VIII, above, we preliminary believe that, once the tools necessary to carry out on-going monitoring would have been put in place, a broker-dealer would be able to incorporate ongoing monitoring and enforcement within the scope of its existing surveillance and enforcement policies and procedures without a substantial additional burden. We recognize, however, that this ongoing compliance would not be cost-free, and that broker-dealers would incur some additional annual costs associated with ongoing compliance, including compliance costs of reviewing transactions. We estimate that each broker-dealer would incur an average annual ongoing compliance cost of $102,768, for a total annual cost of $571,492,848 for all broker-dealers.[389]

As discussed above in connection with the PRA, we realize that the exact nature and extent of the policies and procedures that a broker-dealer would be required to establish likely would vary depending upon the type, size, and nature of the broker-dealer. Thus, while we have based our estimates on the burden estimates provided in connection with the adoption of Regulation NMS, we note that these estimates may be on the high end because broker-dealers have already had to establish policies and procedures in connection with that Regulation's order protection rule, which could help form the basis for the policies and procedures for the proposed modified uptick rule's ''broker-dealer'' provision's policies and procedures requirement in proposed Rule 201(c)(1). We realize, however, that these estimates may be on the low end for some broker-dealers that may have less familiarity with a policies and procedures approach. Thus, we seek specific comment as to whether these estimates are appropriate or whether such estimates should be increased or reduced. If they should be increased or decreased, please address by how much, in order to be able to comply with the proposed modified uptick rule's required policies and procedures, if adopted.

In addition, we anticipate that each trading center would incur initial up-front costs associated with taking action necessary to implement the written policies and procedures it has developed, which would include surveillance and reprogramming costs for enforcing, monitoring, and updating their trading, execution management, and surveillance systems under the proposed modified uptick rule, systems changes to computer hardware and software, as well as staff time and technology resources.[390] However, we note that the policies and procedures that would be required to be implemented are similar to those that are required under Regulation NMS.[391] In accordance with Regulation NMS, trading centers must have in place written policies and procedures in connection with that Regulation's order protection rule, which could help form the basis for the policies and procedures

[387] This figure was calculated by adding $269,046,741 and $111,220,000 (for outsourced legal work). The $269,046,741 figure was calculated as follows: (37 legal hours × $305) + (77 compliance hours × $313) + (23 information technology hours × $292) + (23 business operation hours × $273) = $48,381 per broker-dealer × 5,561 broker-dealers = $ 269,046,741 total cost for broker-dealers. The $111,220,000 figure was calculated as follows: (50 legal hours × $400 × 5,561) = $111,220,000.

Based on industry sources, OEA estimates that the average hourly rate for outsourced legal services in the securities industry is $400. For in-house legal services, we estimate that the average hourly rate for an attorney in the securities industry is approximately $305 per hour.

The $305/hour figure for an attorney is from SIFMA's *Management & Professional Earnings in the Securities Industry 2008,* modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead. In addition, OEA estimates that the average hourly rate for an assistant compliance director, a senior computer programmer, a senior operations manager, in the securities industry is approximately $313, $292, $273 per hour, respectively. These figures are from SIFMA's *Management & Professional Earnings in the Securities Industry 2008,* modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

[388] This figure was calculated as follows: (2 legal hours × 12 months × $305) × 5,561 + (3 compliance hours × 12 months × $313) × 5,561 = $103,367,868.

[389] We estimate that each broker-dealer would incur an average annual ongoing compliance cost of $102,768 for a total annual cost of $571,492,848 for all broker-dealers. This figure was calculated as follows: (16 compliance hours × $313) + (8 information technology hours × $292) + (4 legal hours × $305) × 12 months = $102,768 per broker-dealer × 5,561 broker-dealers = $571,492,848. As discussed above, we base our estimate of burden hours on the estimates used for Regulation NMS because it requires similar ongoing monitoring and surveillance for and enforcement of trading in compliance with that regulation's policies and procedures requirement.

For in-house legal services, we estimate that the average hourly rate for an attorney in the securities industry is approximately $305 per hour. The $305/hour figure for an attorney is from SIFMA's *Management & Professional Earnings in the Securities Industry 2008,* modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead. In addition, OEA estimates that the average hourly rate for an assistant compliance director, a senior computer programmer, a senior operations manager, in the securities industry is approximately $313, $292, $273 per hour, respectively. These figures are from SIFMA's *Management & Professional Earnings in the Securities Industry 2008,* modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

[390] For instance, to implement the proposed modified uptick rule would require that each ATS reprogram their trading engine, as would any broker-dealer who executes trades as an OTC market maker. Moreover, one commenter indicated that programming costs across sell-side firms could range from $200,000 to $2 million. *See, e.g.,* 2007 Price Test Adopting Release, 72 FR at 36350 n. 113 (citing comment letter from SIFMA stating that cost estimates for firms to program for the changes that were necessary to meet the policies and procedures requirements of Regulation NMS varied, from as low as approximately $200,000 for some firms to as high as $2 million for others. *See also supra* note 46 (citing to 2007 SIFMA letter) and text accompanying note 208. Additionally, because they might require trading centers and other market participants a significant amount of time in which to reprogram and test their systems to comply with the proposed amendments, these systems and programming costs might be higher without a sufficient implementation period. For example, this same commenter indicated that it would take six to nine months to implement a new version of the bid test. *See id.*

See letter from Credit Suisse (discussing need for a longer implementation period, particularly for smaller broker-dealers, in terms of having to build systems to be able to track upticks or upbids in their smart order routers in accordance with any new rules and then preserve this history so that regulators can audit it). According to this commenter, ''[b]uilding such systems would likely be as expensive and challenging as Reg NMS implementation was from 2005–2007, and would likely take more than a year to implement * * * It is also likely that the compliance costs would disproportionately burden smaller BDs, who would likely be forced to route their order flow through a handful of larger brokers, impeding competition and adding to systemic risk as flow is consolidated among fewer players''. *Id.*

We also recognize that the proposed amendments, if adopted, would require the commitment of resources associated with compliance oversight, market surveillance, and enforcement, with attendant opportunity costs.

[391] *See* Regulation NMS Adopting Release, 70 FR 37496. *See also* 17 CFR 242.611.

for the proposed modified uptick rule.[392] Thus, we believe trading centers may already be familiar with establishing, maintaining, and enforcing trading-related policies and procedures, including programming their trading systems in accordance with such policies and procedures.

We believe this familiarity may reduce the implementation costs of the proposed modified uptick rule on trading centers and may make the proposed modified uptick rule less burdensome to implement. Moreover, because trading centers have already developed or modified their surveillance mechanisms in order to comply with Regulation NMS's policies and procedures requirement, trading centers may already have retained and trained the necessary personnel to ensure compliance with that Regulation's policies and procedures requirements and, therefore, may already have in place most of the infrastructure and potential policies and procedures necessary to comply with the proposed modified uptick rule.[393]

Thus, while we believe there would be costs associated with systems modifications and training staff that would be affected by these systems modifications, because most trading centers would already have in place systems, written policies and procedures in order to comply with Regulation NMS's order protection rule, we believe trading centers would already be familiar with establishing, maintaining, and enforcing trading-related policies and procedures, including programming their trading and surveillance systems in accordance with such policies and procedures.

Moreover, the proposed modified uptick rule's written policies and procedures requirement are designed to provide trading centers with significant flexibility in determining how to comply with the requirements of the proposed modified uptick rule. For example, the proposed modified uptick rule is designed to provide trading centers and their customers with flexibility in determining how to handle orders that are not immediately executable or displayable by the trading center because the order is impermissibly priced. Thus, if an order were impermissibly priced, the trading center could, in accordance with policies and procedures reasonably designed to prevent the execution or display of a short sale at a down-bid price, re-price the order at the lowest permissible price and hold it for later execution at its new price or better.[394] As quoted prices change, the proposed modified uptick rule would allow a trading center to repeatedly re-price and display an order at the lowest permissible price down to the order's original limit order price (or, if a market order, until the order is filled). Because a trading center could re-price and display a previously impermissibly priced short sale order, the proposed modified uptick rule may allow for the more efficient functioning of the markets because trading centers would not have to reject or cancel impermissibly priced orders unless instructed to do so by the trading center's customer submitting the short sale order.

Moreover, while latencies in obtaining data regarding the national best bid from consolidated market data feeds, as discussed in detail above, could impact implementation costs associated with the proposed modified uptick rule, a trading center could have policies and procedures that could provide a snapshot of the market to identify the current national best bid at the time of execution or display of a short sale order. Such snapshots may cause a reduction in costs for trading centers by helping to verify whether a short sale order was executed or displayed at a permissible price.

b. Proposed Uptick Rule

The alternative proposed uptick rule would be based on the last sale price, rather than the national best bid, as the reference point for short sale orders, similar to former Rule 10a–1. However, the proposed uptick rule would not include an explicit policies and procedures requirement. Instead, the proposed uptick rule would prohibit any person from effecting a short sale below the last sale price, unless an exception applies. Because the proposed uptick rule would be a modernized version of the former Rule 10a–1, it would also provide the public with an opportunity to comment on the utility of such a price test, especially in light of recent changes in market conditions.[395]

We recognize that due to the extensive systems changes that have occurred in the last couple of years in response to Regulation NMS, programming systems for the proposed uptick rule could be burdensome.[396] In particular, because the proposed uptick rule does not take a policies and procedures approach, market participants would not be able to rely to the same extent on the policies and procedures they already have in place under Regulation NMS. Instead, the proposed uptick rule would prohibit any person from effecting a short sale in contravention of the rule's limitations. However, because the proposed uptick rule would apply to *any person* effecting a short sale, rather than just to trading centers, the proposed uptick rule might impose costs on more market participants than the proposed modified uptick rule. However, the proposed uptick rule, which is similar to the price test of former Rule 10a–1, would be familiar to many market participants because it would be based on a rule which was in existence for almost 70 years, and was only recently eliminated. We believe this familiarity may help to reduce the implementation costs of the proposed uptick rule on market participants and, therefore, should decrease the costs of implementation of the proposed uptick. For example, we believe some market participants may have retained personnel familiar with former Rule 10a–1,[397] and may also have in place some of the systems and surveillance mechanisms used in connection with former Rule 10a–1 that could be used to comply with the proposed uptick rule. We believe, however, that most market participants would incur costs associated with having to implement or modify their trading systems and surveillance

[392] *See id.*

[393] We also believe some trading centers may have retained personnel familiar with the former SRO bid tests, which may make the proposed modified uptick rule less burdensome to implement. *See, e.g., supra* note 125 and accompanying text.

[394] For example, if a trading center received a short sale order priced at $47.00 when the current national best bid in the security is $47.00, but the immediately preceding national best bid was $47.01 (*i.e.,* the current bid is below the previous bid), the trading center could re-price the order at the permissible offer price of $47.01, and display the order for execution at this new limit price.

[395] *See supra* Section II discussing the history of short sale price test regulation in the United States and the changes in market conditions and resulting erosion of investor confidence.

[396] *See, e.g.,* 2007 Price Test Adopting Release, 72 FR at 36350 n. 113 (citing to comment letter from SIFMA stating that cost estimates for firms to program for the changes that were necessary to meet the policies and procedures requirements of Regulation NMS varied, from as low as approximately $200,000 for some firms to as high as $2 million for others. *See* SIFMA Letter. Additionally, because they might require trading centers, SROs, and other market participants a significant amount of time in which to reprogram and test their systems to comply with a price test restriction, these systems and programming costs might be higher without a sufficient implementation period. For example, one commenter indicated that it would take six to nine months to implement a new version of the price test. *See id.* (discussing SIFMA comment letter) and *see also supra* note 208.

[397] Likewise, we believe some market participants may have retained personnel familiar with former SRO bid tests. *See, e.g., supra* note 125 and accompanying text.

mechanisms in order to comply with the proposed uptick rule, including a period of time in which to make such changes.[398] However, we believe familiarity with a price test that would be based on a modernized version of former Rule 10a–1 might more readily help address investor confidence in our markets.

c. Additional Mitigating Price Test Costs Features

While we recognize that either proposed price test alternatives would create costs for trading centers that execute or display short sale orders in covered securities, as well as other market participants that engage in short selling, we believe there are several additional mitigating costs features that might help to reduce costs associated with a proposed price test if adopted.

First, we believe that the fact that either proposed price test alternative, if adopted, would apply a uniform price test [399] might help to reduce compliance costs for market participants. For example, by applying a uniform price test, the proposed short sale price test restrictions would be designed so as to not result in the type of disparate short sale regulation that existed under former Rule 10a–1, in which different price tests were applied in different markets, resulting in confusion, compliance difficulties, regulatory arbitrage, and an un-level playing field among market participants.[400] Moreover, subsection (e) of proposed Rule 201 of the proposed modified uptick rule and subsection (d) of proposed Rule 201 of the proposed uptick rule, if adopted, would include a requirement that no SRO may have any rule that is not in conformity with, or conflicts with, the proposed short sale price test requirements.[401] Thus, we believe a uniform rule might reduce compliance costs, and also could reduce regulatory arbitrage. Also, there might be a reduction in costs associated with systems and surveillance mechanisms that would have to be programmed to consider only a single test based on the national best bid (or on the last sale price if the proposed uptick rule is adopted) instead of different tests for different markets.

Second, the proposed three month implementation period would be designed to provide trading centers and market participants with a sufficient amount of time in which to modify their systems and procedures in order to comply with the requirements of a proposed short sale price test if adopted and, thus, might help reduce some of the costs and help to alleviate some of the potential disruptions that might be associated with implementing either proposed price test. We recognize, however, that a longer implementation period may be more manageable or preferable, particularly to smaller broker-dealers that might be disproportionately burdened by any implementation and compliance costs associated with the proposed short sale price test restrictions, as well as competitively disadvantaged in terms of reduced order flow as a result.[402] Thus, we seek comment as to what length of implementation period would be necessary or appropriate, and why, such that trading centers would be able to meet the proposed short sale price test restrictions, if adopted.

Third, as described below, we believe the ''broker-dealer'' provision in proposed Rule 201(c)(1) of the proposed modified uptick rule and the provisions contained in paragraph (d) of the proposed modified uptick rule, as well as the exceptions contained in paragraph (c) of the proposed uptick rule might also help to minimize any potential price distortions or costs associated with the proposed short sale price restrictions. These provisions also would be designed to help promote the workability of the proposed price tests, while at the same time furthering the Commission's stated goals of short sale price test regulation.

For example, as discussed above, proposed Rule 201(c)(1) of the proposed modified uptick rule would provide that a broker-dealer may mark a short sale order in a covered security ''short exempt'' and send it to a trading center if the broker-dealer has identified the order as not being at a down-bid price at the time of submission of the order to the trading center. This provision would provide broker-dealers with the option to manage their order flow, rather than having to always rely on their trading centers to manage their order flow on their behalf. In addition, we note that this provision would not undermine the Commission's goals for short sale regulation because any broker-dealer marking an order ''short exempt'' in accordance with this provision would have to ensure that its short sale order was not on a down-bid price at the time of submission of the order to a trading center. We believe that this provision also might help to preserve instant execution and liquidity by allowing relatively unrestricted short selling in an advancing market.

Proposed Rule 201(d)(1) of the proposed modified uptick rule would provide an exception if the seller owns a security and would provide that a short sale order of a covered security may be marked ''short exempt,'' thereby allowing it to be displayed or executed at a down-bid price, if the broker-dealer has a reasonable basis to believe that the seller owned the security being sold and that the seller intended to deliver the security as soon as all the restrictions on delivery have been removed. Similarly, proposed Rule 201(c)(1) of the proposed uptick rule would provide an exception for sales of owned securities. As a result, these provisions would allow for sales of securities that although owned, were subject to the provisions of Regulation SHO governing short sales due solely to the seller being unable to deliver the security to its broker-dealer prior to settlement due to circumstances outside the seller's control.

Proposed Rule 201(d)(2) of the proposed modified uptick rule would allow a broker-dealer to mark a short sale order ''short exempt'' if the broker-dealer has a reasonable basis to believe that the short sale order is by a market maker to off-set a customer odd-lot order or to liquidate an odd-lot position by a single round lot sell order that changed such broker-dealer's position by no more than a unit of trading and, thereby, may be permitted to be executed or displayed at a down-bid price. Similarly, in proposed Rule 201(c)(3) of the proposed uptick rule we would provide an exception for sales related to odd-lot orders. These provisions would allow market makers to facilitate customer orders that are not of a size that could facilitate a downward price movement in the market.

Proposed Rule 201(d)(3) of the proposed modified uptick would permit qualifying short sale orders associated with certain bona fide domestic arbitrage transactions to be marked ''short exempt,'' and thereby permit them to be executed or displayed at a down-bid price. This provision would allow broker-dealers to engage in transactions that tend to reduce pricing disparities between securities.

[398] *See, e.g., supra* note 346.

[399] As discussed above, unlike the former Rule 10a–1, the proposed short sale price test restrictions, if adopted, would apply a uniform rule to trades in the same securities that occur in multiple, dispersed, and diverse markets. Under the proposed short sale price test restrictions, all covered securities, wherever traded, would be subject to the same short sale price test.

[400] *See supra* note 27 (discussing the different tests under former Rule 10a–1).

[401] *See* proposed Rule 201(e) of the proposed modified uptick rule, and proposed Rule 201(d) of the proposed uptick rule.

[402] *See supra* note 390 and accompanying text (discussing letters from SIFMA and Credit Suisse, respectively, regarding cost estimates and the need for a longer implementation period, particularly for smaller broker-dealers).

Moreover, to facilitate arbitrage transactions in which a short position was taken in a security on the U.S. market, and which was to be immediately covered on a foreign market, Rule 201(d)(4) of the proposed modified uptick rule would permit short sale orders associated with certain international arbitrage transactions to be marked ''short exempt,'' and thereby permit such orders to be executed or displayed at a down-bid price. Similarly, proposed Rules 201(c)(4) and 201(c)(5) of the proposed uptick rule would provide exceptions related to domestic and international arbitrage transactions.

In addition, proposed Rule 201(d)(5) of the proposed modified uptick rule is intended to facilitate distributions of securities by providing an exception for any sales of covered securities by underwriters or members of a syndicate or group participating in the distribution of a security in connection with an over-allotment of securities, and any lay-off sales by such persons in connection with a distribution of securities through a rights or standby underwriting commitment. By permitting short sales in connection with an over-allotment or lay-off sales at or below the national best bid to be marked ''short exempt,'' and thereby permit them to be executed or displayed at a down-bid price, this provision would enable an underwriter to reduce its risk by pricing an offering at or below the current national best bid or last sale price, as applicable. Similarly, proposed Rule 201(c)(6) of the proposed uptick rule would provide an exception for sales in connection with over-allotments and lay-off sales.

As discussed above, proposed Rule 201(d)(6) of the proposed modified uptick rule would allow a broker-dealer to mark short sale orders of a covered security ''short exempt,'' and thereby allow for their execution or display at a down-bid price where a broker-dealer is facilitating customer buy orders or sell orders where the customer is net long and the broker-dealer is net short but is effecting the sale as riskless principal, provided certain conditions are met. Similarly, proposed Rule 201(c)(9) of the proposed uptick rule would provide an exception for certain transactions on a riskless principal basis. These provisions would provide broker-dealers with additional flexibility to facilitate customer orders.

Proposed Rule 201(d)(7) of the proposed modified uptick rule would permit certain short sale orders executed on a VWAP basis to be marked ''short exempt,'' and, as a result, to be executed or displayed at a down-bid price.[403] Similarly, proposed Rule 201(c)(7) of the proposed uptick rule would provide an exception for certain transactions on a VWAP basis. These provisions might help provide an additional source of liquidity for investors' VWAP orders and might help enable investors to achieve their objective of obtaining an execution at the VWAP.

In addition, the proposed uptick rule would include cost-mitigating provisions that would be unique to the proposed uptick rule, designed to allow its proper functioning in today's markets, while at the same time being designed to further the purposes of our proposing short sale price test restrictions at this time. For example, proposed Rule 201(c)(2) of the proposed uptick rule would provide an exception for errors in marking a short sale order, such as when a broker-dealer effected a sale marked ''long'' by another broker-dealer, but the sale was mis-marked such that it should have been marked as a ''short'' sale.[404] This exception might help promote liquidity by avoiding implicating the broker-dealer effecting the sale where the broker-dealer's participation in the violation was neither knowing nor reckless.[405]

Proposed Rule 201(c)(8) of the proposed uptick rule would provide an exception from the proposed uptick rule for any sale of a covered security in an electronic trading system that matches buying and selling interest at various times throughout the day as long as such sales meet certain criteria. This exception might help promote market efficiency and liquidity by accommodating the increased use of automated trading systems and alternative strategies used in today's marketplace. It might also help provide an additional source of liquidity for investors' passively priced orders and better enable investors to engage in alternative trading strategies to achieve their investment objectives.

Proposed Rule 201(c)(10) and (c)(11) of the proposed uptick rule might also help promote market efficiency and liquidity by providing exceptions to the requirements of the proposed uptick rule to help address conflicts between the proposed uptick rule and the Quote Rule under Rule 602 of Regulation NMS.[406]

Proposed Rule 201(c)(12) of the proposed uptick rule would provide an exception from the proposed uptick rule for any sale of a security at the offer by a registered market maker or specialist publishing two-sided quotes to sell short to facilitate customer market and marketable limit orders to buy regardless of the last sale price. This exception is intended to help provide relief in a decimals environment to registered market makers and specialists so that they could provide liquidity in response to customer buy orders.

2. Proposed Circuit Breaker Halt Rule

We recognize that the proposed circuit breaker halt rule, if adopted, would impose costs on market participants to implement and assure compliance with the proposed circuit breaker halt rule's requirements. These costs could, in sum, increase the costs of legitimate short selling. For example, the proposed circuit breaker halt rule, when triggered, would impose a short selling halt that might restrict otherwise legitimate short selling activity during periods of extreme volatility. As such, we recognize that the proposed circuit breaker halt rule might result in a reduction of the benefits of legitimate short selling and, thereby, could result in a subsequent reduction in short selling generally. Such a reduction might lead to a decrease in market efficiency and price discovery, less protection against upward stock price manipulations, a less efficient allocation of capital, an increase in trading costs, and a decrease in liquidity.[407] Thus, we believe there might be potential costs associated with the proposed circuit breaker halt rule in terms of potential impact of such a halt on quote depths, spread widths, and market liquidity.

In addition, we recognize that imposing a circuit breaker halt rule when, currently, there is an absence of a short selling halt may result in costs in terms of modifications to systems and surveillance mechanisms, as well as changes to processes and procedures. We anticipate that these changes would likely result in immediate implementation costs for market participants associated with reprogramming trading and surveillance systems to now account for the requirements of the proposed circuit breaker halt, if adopted. We also believe the proposed circuit breaker halt rule may impose costs to market participants related to systems changes to computer hardware and software, reprogramming costs, and surveillance and compliance costs, as well as staff time and technology resources, associated with

[403] *See supra* note 181 (citing to VWAP relief letters under former Rule 10a–1).

[404] *See* proposed Rule 201(d)(2).

[405] *Id.*

[406] *See* 17 CFR 242.602.

[407] *See* Section IX.B. (discussing costs of the proposed modified uptick rule and proposed uptick rule).

monitoring compliance with the proposed circuit breaker halt rule.[408]

Moreover, imposing a circuit breaker halt rule when there are currently no short sale halts in place also could mean that staff (compliance personnel, associated persons, etc.) might need to be trained or re-trained regarding rules related to the circuit breaker requirements. Also, market participants could be required to hire additional staff (and train or re-train them) to comply with the proposed circuit breaker halt rule. As such, we believe the proposed circuit breaker halt rule, if adopted, might impose training and compliance costs for market participants.

While we recognize that market participants would incur initial up-front costs associated with having to update their systems, including systems changes to computer hardware and software, as well as staff time and technology resources to update their systems and surveillance mechanisms in order to ensure compliance with the requirements of the proposed circuit breaker halt rule,[409] we believe that many of the systems changes that would be required to be implemented are similar to what was already required for implementation under Regulation NMS.[410] Thus, we believe market participants may already have developed or programmed their trading and surveillance systems in accordance with the requirements of Regulation NMS which may help to reduce any implementation costs associated with the proposed circuit breaker halt rule and, therefore, may make the proposed circuit breaker halt rule less burdensome to implement.

Thus, while we believe there would be costs associated with systems modifications and training staff that would be affected by these systems modifications, because most market participants would already have in place systems in order to comply with Regulation NMS, market participants may already have in place most of the infrastructure and processes necessary to comply with the proposed circuit breaker halt rule. Moreover, because the proposed circuit breaker halt rule might require less substantial modifications to existing systems, the implementation and compliance costs may not be significant.[411] As discussed above, currently, all stock exchanges and FINRA have rules or policies to implement coordinated circuit breaker halts.[412] Moreover, SROs have rules or policies in place to coordinate individual security trading halts corresponding to significant news events.[413] Information on the securities subject to SRO regulatory trading halts is disseminated to market participants through the CMS and other electronic media.[414] We, however, seek comment as to whether the time and implementation costs associated with the proposed circuit breaker halt rule may be lower than other alternatives proposed.

We, however, recognize that there may be concerns about a potential ''magnet effect'' that could arise as an unintended consequence of the proposed circuit breaker halt rule that could halt short selling and result in short sellers driving down the price of an equity security in a rush to execute short sales before the circuit breaker would be triggered. As discussed above, one commenter noted that a short sale circuit breaker could exacerbate downward pressure on stocks as their value reached the threshold level.[415] Another commenter, however, in discussing the issue of a ''magnet effect'' cited empirical studies that question whether a circuit breaker would result in artificial pressure on the price of individual securities.[416]

In addition, we note that the proposed circuit breaker halt rule would include exceptions substantially identical to exceptions in the Short Sale Ban that would be designed to allow its proper functioning in today's markets and allow broker-dealer to provide liquidity to the market, while at the same time being designed to further the purposes of our proposing the alternative circuit breaker halt rule at this time.[417]

We believe the proposed circuit breaker halt rule should include exceptions that mirror certain of the exceptions in the Short Sale Ban because the proposed rule shares the same goal of prohibiting short selling that might exacerbate a price decline during a period of sudden and excessive price declines. For example, the proposed circuit breaker halt would include a bona fide market maker exception, which would allow market makers to effect a short sale as part of bona fide market making and hedging activity related directly to bona fide market making in derivatives on the publicly traded securities of a covered security. This proposed exception would permit market makers to continue to provide liquidity to the markets, facilitate orders, and otherwise comply with their obligations as market makers. This proposed exception would also apply to options market makers that sell short equity securities to hedge options positions.

The proposed exception for short sales that occur as a result of automatic exercise or assignment of an equity option held before a circuit breaker on a particular security is triggered and a short selling halt is imposed in that security due to expiration of the option would allow short sales that occur as a result of the expiration of options contracts held before a circuit breaker is triggered in a particular security. This would allow persons that purchased or sold options prior to the effectiveness of a circuit breaker halt entered into such transactions with the expectation that they would be able to fulfill their contractual obligations and receive the benefits of their bargain in return. Providing this proposed exception to the circuit breaker halt rule would not raise the concerns that a circuit breaker rule is intended to address.

To allow for creation of long call options, the proposed exception would permit short sales that occur as a result of assignment to call writers upon exercise. When options are exercised, call writers may be required to sell short in order to satisfy their obligations. Because call writers do not have discretion, and because the short sales are effected in order to fill buying

[408] *See id.*

[409] *See, e.g.,* 2007 Price Test Adopting Release, 72 FR at 36350 n. 113 (citing comment letter from SIFMA stating that cost estimates for firms to program for the changes that were necessary to meet the requirements of Regulation NMS varied, from as low as approximately $200,000 for some firms to as high as $2 million for others. *See also* letter from Credit Suisse.

[410] *See* Regulation NMS Adopting Release, 70 FR 37496. *See also* 17 CFR 242.611.

[411] *See* letter from Credit Suisse (stating that ''[i]mplementation could be fast and costs would be modest'' and that ''listing exchanges already disseminate real-time status conditions as part of existing price feeds. By generalizing the existing ''Regulatory Halt'' flag to include a ''Do Not Short'' condition, both away trading venues and broker-dealers could react to the circuit breaker condition in real-time with very little coding and testing'').

[412] *See* Securities Exchange Act Release No. 39846 (Apr. 9, 1998), 63 FR 18477 (Apr. 15, 1998) (order approving proposals by Amex, BSE, CHX, NASD, NYSE, and Phlx) (''1998 Release''). *See also* NYSE Rule 80B. The circuit breaker procedures call for cross-market trading halts when the DJIA declines by 10 percent, 20 percent, and 30 percent from the previous day's closing value. *See e.g.,* BATS Exchange Rule 11.18.

[413] *See, e.g.,* FINRA Rule 6120.

[414] For example, in addition to disseminating news of trading halts through the CMS, Nasdaq publishes a daily list of securities subject to trading halts indicating the name of the issuer, the time the halt was initiated, and where applicable, the times at which quoting and trading may resume.

[415] *See* letter to Mary Schapiro, Chairman, from Direct Edge, dated March 30, 2009.

[416] *See* letter from Credit Suisse (discussing potential costs associated with short sale price test restrictions and circuit breaker rules).

[417] *See* Section III, above (discussing exceptions to proposed circuit breaker halt rule). *See also* Securities Exchange Act Release No. 58592 (Sept. 18, 2008), 73 FR 55169–02 (Sept. 24, 2008) (regarding exceptions to the Short Sale Ban).

demand, we believe that including this exception in the proposed circuit breaker halt rule would benefit the markets while not opening the door to the abuses that the proposed rule is intended to address.

The proposed exception for securities that a seller is deemed to own under Rule 200(b) (because Rule 144 securities are owned securities and do not raise the concerns that a short sale circuit breaker halt would be designed to address) would, during a halt triggered by a circuit breaker, allow sellers to sell securities that although owned, are subject to the provisions of Regulation SHO governing short sales due solely to the seller being unable to deliver the security to its broker-dealer prior to settlement based on circumstances outside the seller's control.

We seek comment regarding any benefits or costs associated with the above described exceptions to the proposed circuit breaker halt rule.

3. Proposed Circuit Breaker Price Test Rules

We also recognize that the proposed circuit breaker price test restrictions would result in costs on market participants responsible for implementing and assuring compliance with such requirements. We anticipate that there might be significant operational costs associated with reprogramming systems to comply with the proposed circuit breaker price test rules. We also anticipate that these costs might be greater than those required to comply with the proposed circuit breaker halt rule described above, which would, when triggered, impose a halt on short selling in individual NMS stocks rather than impose specific price test restrictions.[418] In addition, we believe there might also be costs incurred for additional staff and costs associated with personnel hiring and training related to maintaining and ensuring compliance with the proposed circuit breaker price test rules.[419]

Further, we recognize that short sale price test restrictions that would be imposed as a result of the proposed circuit breaker price test rules being triggered might result in many of the same costs discussed in detail in Section IX.B.1 pertaining to the implementation of market-wide short sale price test restrictions.[420] Those costs might include a reduction of the benefit of legitimate short selling and a subsequent reduction in the quantity of short selling, which we recognize might lead to a decrease in market efficiency and price discovery, less protection against upward stock price manipulations, a less efficient allocation of capital, an increase in trading costs, and a decrease in liquidity.[421]

Although under the proposed circuit breaker price test rules, a price test would not be in place full-time or for all securities, if the proposed circuit breaker modified uptick rule is adopted, trading centers would need to establish reasonable policies and procedures in advance to ensure compliance whenever a circuit breaker, and thus the proposed circuit breaker modified uptick rule, is triggered. We note that it would not be reasonable for a trading center to wait until the circuit breaker is triggered to begin establishing reasonable policies and procedures to prevent the execution or display of the particular NMS stock on a down-bid. Thus, we recognize that both of the proposed circuit breaker price tests would result in immediate upfront costs to trading centers.[422]

However, while we recognize that either proposed circuit breaker price test would create costs for trading centers that execute or display short sale orders in covered securities, as well as other market participants that engage in short selling, we note that the proposed circuit breaker price tests would include the same cost-mitigating provisions discussed in Section IX(B)(1)(c) pertaining to the market-wide short sale price test restrictions that might help to reduce costs associated with the proposed circuit breaker price tests, while at the same time being designed to further the purposes of our proposing the alternative circuit breaker price test restrictions at this time.[423] For example, we believe that the fact that either proposed circuit breaker price test, if adopted, would apply a uniform price test[424] might help to reduce compliance costs for market participants associated with systems and surveillance mechanisms that would have to be programmed to consider only a single circuit breaker price test instead of different tests for different markets.

Second, the proposed three month implementation period would be designed to provide trading centers and market participants with a sufficient amount of time in which to modify their systems and procedures in order to comply with the requirements of either proposed circuit breaker price test, if adopted, and, thus, might help reduce some of the costs and help to alleviate some of the potential disruptions that might be associated with implementing either proposed circuit breaker price test. We recognize, however, that a longer implementation period may be more manageable or preferable, particularly to smaller broker-dealers that might be disproportionately burdened by any implementation and compliance costs associated with the proposed circuit breaker price test restrictions, as well as competitively disadvantaged in terms of reduced order flow as a result.[425] Thus, we seek comment as to what length of implementation period would be necessary or appropriate, and why, such that trading centers would be able to meet the proposed circuit breaker price test restrictions, if adopted.

Third, as described below, we believe the ''broker-dealer'' provision in proposed Rule 201(c)(1) of the proposed circuit breaker modified uptick rule and the provisions contained in paragraph (d) of the proposed circuit breaker modified uptick rule, as well as the exceptions contained in paragraph (c) of the proposed circuit breaker uptick rule might also help to minimize any potential price distortions or costs associated with the proposed circuit breaker price restrictions. These provisions also would be designed to help promote the workability of the proposed circuit breaker price tests, while at the same time furthering the

[418] *See also* Sections IX.B.1. (discussing costs of the proposed modified uptick rule and proposed uptick rule).

[419] *See, e.g.*, letter from Credit Suisse (discussing potential costs associated with short sale price restrictions and circuit breaker rules). *See also* Section IX.B. (discussing costs associated with proposed modified uptick rule and proposed uptick rule).

[420] *See* Section IX.B.1. (discussing costs and benefits of the proposed modified uptick rule and the proposed uptick rule). *See also* Section IX.B.1.a. (discussing burden hour estimates, for purposes of the PRA, in connection with the proposed policies and procedure requirements under the modified uptick rule, the riskless principal exception to the proposed uptick rule, and the proposed marking requirements).

[421] *See* Section IX.B.1. (discussing costs of the proposed modified uptick rule and proposed uptick rule).

[422] *See id.*

[423] *See id.*

[424] As discussed above, unlike the former Rule 10a–1, the proposed short sale price test restrictions, if adopted, would apply a uniform rule to trades in the same securities that occur in multiple, dispersed, and diverse markets. Under the proposed short sale price test restrictions, all covered securities, wherever traded, would be subject to the same short sale price test.

[425] *See* letter from Credit Suisse *supra* note 122 (discussing need for a much longer implementation period, particularly for smaller broker-dealers). According to this commenter, compliance costs associated with a bid or tick test would disproportionately burden smaller broker-dealers, who would likely be forced to route their flow through a handful of larger broker-dealers, impeding competition and adding to systemic risk as flow is consolidated among fewer players).

Commission's stated goals of short sale price test regulation.[426]

4. Proposed Marking Requirements

We do not anticipate that the ''short exempt'' marking requirements would impose significant costs on broker-dealers. For example, such broker-dealers might incur a one-time cost associated with implementation and reprogramming. In connection with the order marking requirements of Rule 200(g) of Regulation SHO, which had originally included the category of ''short exempt,'' industry sources at that time estimated initial implementation costs for the former ''short exempt'' marking requirement to be approximately $100,000 to $125,000.[427]

In addition, we do not believe the proposed order marking requirements would impose significant ongoing monitoring and surveillance costs for broker-dealers. Broker-dealers already have established systems, processes, and procedures in place to comply with the current marking requirements of Rule 200(g) of Regulation SHO with respect to marking a sell order either ''long'' or ''short'' and, thus, would likely continue to use such systems, processes and procedures to comply with the proposed ''short exempt'' marking requirements in proposed Rules 200(g) and 200(g)(2).

We recognize that there would be an ongoing paperwork burden cost associated with adding the ''short exempt'' marking requirements. For example, as discussed in detail in Section VIII, above, for purposes of the PRA, we estimate that it would take each broker-dealer no more than approximately .000139 hours (.5 seconds) to mark a sell order ''short exempt.'' In addition, we estimate that the total annual hour burden per year for each broker-dealer subject to the proposed ''short exempt'' marking requirements would be 322 hours.

If we were to adopt the proposed ''short exempt'' marking requirements of proposed Rules 200(g) of the proposed modified uptick rule (or the proposed circuit breaker modified uptick rule) or the proposed uptick rule (or the proposed circuit breaker uptick rule), or the proposed circuit breaker halt rule, we are proposing an implementation period under which market participants would have to comply with these requirements three months following the effective date of the proposed marking requirements. We believe that this proposed implementation period would provide market participants with sufficient time in which to modify their systems and procedures in order to comply with the proposed ''short exempt'' marking requirements. We realize, however, that a shorter or longer implementation period may be manageable or preferable. Thus, we seek specific comment as to what length of implementation period would be necessary or appropriate, and why, such that market participants would be able to meet the proposed marking requirements, if adopted.

C. Request for Comment

We are sensitive to the costs and benefits of the proposed amendments, and encourage commenters to discuss any additional costs or benefits beyond those discussed herein, as well as any reduction in costs. Commenters should provide analysis and data to support their views of the costs and benefits associated with the proposed amendments.

Questions Regarding Proposed Short Sale Price Test Restrictions

1. The Commission believes that the erosion of investor confidence and questions concerning the volatility in the securities markets necessitate review of various alternatives with respect to short selling restrictions. Would the proposed market-wide short sale price test restrictions be more appropriate than the proposed circuit breaker rules in current market conditions? If so, why? If not, why not? Would the proposed market-wide short sale price test restrictions provide more potential benefit to the market than the proposed circuit breaker rules? Please explain. For example, would the proposed market-wide short sale price test restrictions be a more appropriate means for the Commission to achieve the objective helping to prevent short selling from being used as a tool to drive down the market? Please explain. Would the proposed market-wide short sale price test restrictions help to address the Commission's concerns regarding investor confidence? If so, why and how? If not, why not?

2. What would be the costs and benefits of the proposed modified uptick rule versus the proposed uptick rule? Is a policies and procedures approach preferable to a prohibition on executing a short sale on a down-bid price? Why or why not? What would be the costs and benefits of a policies and procedures approach as compared to such a prohibition? Should we consider other forms of short sale price tests? What would be the costs and benefits of any alternative forms of short sale price tests?

3. What would be the costs and benefits of short sales being subject to the proposed modified uptick rule? What would be the costs and benefits of short sales being subject to the proposed uptick rule? What would be the costs and benefits of having a uniform short sale price test in the covered securities across all markets? Please explain.

4. What, if any, additional benefits, beyond those discussed herein, would result from the proposed modified uptick rule? What, if any, additional benefits, beyond those discussed herein, would result from the proposed uptick rule? Should either proposed price test be modified in any way to increase the benefits of a short sale price test? If so, how?

5. What, if any, additional costs, beyond those discussed herein, would result from the proposed modified uptick rule? What, if any, additional costs, beyond those discussed herein, would result from the proposed uptick rule? What would be the types of costs, and what would be the amounts? Should the proposed short sale price tests be modified in any way to mitigate costs? If so, how?

6. How would trading systems and strategies used in today's marketplace be impacted by the proposed modified uptick rule? How might market participants alter their trading systems and strategies in response to the proposed modified uptick rule, if adopted?

7. Would the proposed modified uptick rule create any additional implementation or operational costs associated with systems (including computer hardware and software), surveillance, procedural, recordkeeping, or personnel modifications, beyond those discussed herein? Would the proposed uptick rule create any additional implementation or operational costs associated with systems (including computer hardware and software), surveillance, procedural, recordkeeping, or personnel modifications, beyond those discussed herein?

8. Would smaller trading centers and other market participants be disproportionately impacted by any additional implementation or operational costs associated with systems (including computer hardware and software), surveillance, procedural, recordkeeping, or personnel modification as a result of the proposed short sale price test restrictions? If so, in what way. Please explain.

9. To comply with the proposed modified uptick rule, broker-dealers

[426] *See* Section IX.B.1.c. (discussing cost-mitigating features of proposed modified uptick rule and proposed uptick rule in detail).

[427] *See* 2004 Regulation SHO Adopting Release, 69 FR at 48023.

might be required to purchase new systems or implement changes to existing systems. Would changes to existing systems be significant? What would be the costs and benefits associated with acquiring new systems or making changes to existing systems? What, if any, changes would need to be made to existing recordkeeping systems? What would be the costs and benefits associated with any changes? How might smaller broker-dealers be impacted by having to purchase new systems or implement changes to existing systems in order to comply with the proposed modified uptick rule, if adopted?

10. To comply with the proposed uptick rule, broker-dealers might be required to purchase new systems or implement changes to existing systems. Would changes to existing systems be significant? What would be the costs and benefits associated with acquiring new systems or making changes to existing systems? What, if any, changes would need to be made to existing records? What would be the costs and benefits associated with any changes?

11. What would be the costs and benefits of requiring trading centers to establish, maintain, and enforce written policies and procedures reasonably designed to prevent the execution or display by the trading center of impermissibly priced short sale orders? What would be the costs and benefits of requiring trading centers to have policies and procedures reasonably designed to permit the execution or display of a short sale order of a covered security marked ''short exempt'' without regard to whether the order is at a down-bid price?

12. What would be the costs and benefits of requiring that trading centers regularly surveil to ascertain the effectiveness of the policies and procedures required by proposed Rule 201(b)(1) and promptly take action to remedy deficiencies in such policies and procedures? What systems and surveillance changes by trading centers would be necessary to meet the requirements of the proposed modified uptick rule?

13. Would the proposed modified uptick rule's compliance and surveillance requirements disproportionately burden smaller broker-dealers? If so, in what way? Please explain.

14. How much, if any, would the proposed price test restrictions affect compliance costs (*e.g.*, personnel or system changes) for each category of broker-dealers: small, medium, and large?

15. Would the proposed modified uptick rule affect different trading centers differently? If so, how? If not, why?

16. Would there be any increases in staffing and associated overhead costs for trading centers and broker-dealers? Would other resources need to be re-dedicated to comply with the proposed modified uptick rule or proposed uptick rule?

17. What, if any, impact on competition would the proposed price test restrictions have on smaller broker-dealers, *e.g.*, due to systems modifications and implementation costs. Please explain.

18. We solicit comment on whether any costs associated with the proposed modified uptick rule and proposed uptick rule would be incurred on a one-time or ongoing basis, as well as cost estimates. In addition, we seek comment as to whether the exceptions to the proposed modified uptick rule or proposed uptick rule would decrease or increase any costs for any market participants. We seek comment about any other costs and cost reductions associated with the proposed amendments.

19. Would the proposed short sale price tests increase the costs of legitimate short selling and lessen some of the benefits of legitimate short selling, which, in turn, could result in a reduction of short selling? To what extent, if any, would the proposed short sale price tests impact legitimate short selling and market efficiency?

20. We seek comment regarding types of entities that would be affected, and the manner in which they would be affected, by the proposed amendments.

21. We seek specific comments on the costs associated with systems changes for trading centers and broker-dealers, including the type of systems changes necessary and quantification of costs associated with changing the systems, including both start-up costs and maintenance. We request comments on the types of jobs and staff that would be affected by systems modifications and training with respect to the proposed modified uptick rule or proposed uptick rule, the number of labor hours that would be required to accomplish these matters, and the compensation rates of these staff members.

22. Would reinstating a short sale price test restriction such as the proposed modified uptick rule or proposed uptick rule help restore investor confidence? If so, why? If not, why not? We note that short selling provides the market with important benefits, including market liquidity and pricing efficiency.[428] What effect, if any, would the proposed modified uptick rule have on market liquidity? What effect, if any, would the proposed modified uptick rule have on pricing efficiency? Please provide empirical data in support of any arguments and/or analyses.

23. Should short sales be subject to a short sale price test restriction, or should we continue to rely on current short sale regulations, as well as anti-fraud and anti-manipulation provisions of the securities laws to address issues raised by potentially abusive short selling? What would be the costs and benefits of subjecting short sales to a short sale price test restriction versus the current short sale regulations, as well as anti-fraud and anti-manipulation provisions of the securities laws?

24. We request comments on whether the pricing of securities affected by any short sale price test would be more or less efficient.

25. We request comments on whether the pricing of securities affected by the proposed modified uptick rule would be more or less efficient.

26. We request comments on whether the pricing of securities affected by the proposed uptick rule would be more or less efficient.

27. If a short sale price test restriction were introduced, the rule would require some commitment of resources associated with compliance oversight, market surveillance, and enforcement. What would be the associated opportunity costs? What level of additional resources would be needed for that oversight, surveillance, and enforcement?

Questions Regarding Proposed Circuit Breaker Halt Rule

1. The Commission believes that the erosion of investor confidence and questions concerning the volatility in the securities markets necessitate review of various alternatives with respect to short selling restrictions. Would the proposed circuit breaker halt rule be more appropriate than a market-wide short sale price test restriction in current market conditions? If so, why? If not, why not? Would the proposed circuit breaker halt rule provide more potential benefit to the market than a market-wide short sale price test restriction? Please explain. For example, would the proposed circuit breaker halt rule be a more appropriate means for the Commission to achieve the objective, helping to prevent short selling from being used as a tool to drive down the market? Please explain. Would the

[428] *See* Section II.A.

proposed circuit breaker halt rule help to address the Commission's concerns regarding investor confidence? If so, why and how? If not, why not?

2. Would implementation of the proposed circuit breaker halt rule be less or more costly than the implementation of a market-wide short sale price test restriction? Would the proposed circuit breaker halt rule that, when triggered, would impose a temporary halt on short selling be more or less costly than one that resulted in a short sale price test restriction? Please explain. Would the proposed circuit breaker halt rule be generally easier to implement in a post-Regulation NMS environment than a market-wide short sale price test restriction such as the proposed modified uptick rule, or the proposed uptick rule? Are there any additional costs associated with multiple day circuit breakers when compared to same day circuit breakers?

3. Should the proposed circuit breaker halt rule be adopted in addition to a permanent, market-wide short sale price test restriction rule? Thus, while a short sale price test restriction rule would be in place as a permanent, market-wide rule, a circuit breaker would also trigger a short selling halt in any security that suffers a severe price decline. Please describe the advantages and disadvantages of such an approach.

4. What would be the relative advantages and disadvantages of a short sale price test combined with a circuit breaker halt rule versus those of a short selling circuit breaker with short sale price test restrictions? Please explain.

5. The Commission is seeking comment on the potential impact of the proposed circuit breaker halt rule on market function and efficiency. What would be the impact of the proposed circuit breaker halt rule, when triggered, on the liquidity of individual securities? What would be the impact of the proposed circuit breaker halt rule on capital formation? What would be the impact of the proposed circuit breaker halt rule on price discovery? Would different circuit breaker alternatives have different impacts on liquidity, capital formation and price discovery? Would a multiple circuit breaker impose any unique costs? Please explain.

6. Should the percentage decline be linked to the stock's price level such that stocks with lower prices must experience a greater percentage decline before the circuit breaker is triggered? If so, what thresholds are appropriate? Please explain. If the percentage decline is linked to price level, what additional operational burdens would be experienced if stock values were required to be continuously monitored due to frequent fluctuation? Please explain. What costs and benefits may accrue from having the decline based on a dollar amount rather than a value derived from a percentage of the share value? What potential problems or benefits may arise from pegging a short selling circuit breaker threshold to a decline in a stock's dollar amount? Please explain.

7. What other benefits, beyond those discussed herein, would be associated with the proposed circuit breaker halt rule? Would the proposed circuit breaker halt rule help stabilize the market for the individual security? If so, why? If not, why not? Would the proposed circuit breaker halt rule benefit investors by allowing the market to ''cool off'' with respect to that individual security? Please explain. Would the proposed circuit breaker halt rule result in an increase in investor confidence? Please explain.

8. What costs, beyond those discussed herein, would be incurred in terms of implementing the proposed circuit breaker halt rule? Please explain. What would it cost to update systems in a manner necessary to ensure compliance with the proposed circuit breaker halt rule? Would the expenditure necessary to ensure compliance be primarily an ''up-front'' cost? Would the expenditure necessary to ensure compliance require long-term investment? Please explain. What technological challenges would be encountered in updating systems to ensure compliance with the proposed circuit breaker halt rule? Please explain. How long would it take to update systems in a manner that ensured compliance with the proposed circuit breaker halt rule? Please explain.

9. What would be the costs and benefits associated with the proposed bona fide market making exception to the proposed circuit breaker halt rule? Please explain. What would be the costs and benefits associated with the proposed exception that would allow short sales that occur as a result of automatic exercise or assignment of an equity option held prior to the effectiveness of the short selling halt due to expiration of the option? Please explain. What would be the costs and benefits associated with the proposed exception for options market makers selling short as part of bona fide market making and hedging activities related directly to bona fide market making in derivatives on the individual security subject to the halt? Please explain.

Questions Regarding Proposed Circuit Breaker Price Test Rules

1. What benefits, beyond those discussed herein, would be associated with the proposed circuit breaker price test rules? Would the proposed circuit breaker price test rules help stabilize the market for the individual security? If so, why? If not, why not? Would the proposed circuit breaker price test rules benefit investors by allowing the market to ''cool off'' with respect to that individual security? Please explain. Would the proposed circuit breaker price test rules result in an increase in investor confidence? Please explain.

2. What would be the benefits of the proposed circuit breaker price test rules versus a permanent, market-wide short sale price test such as the modified uptick rule or the proposed uptick rule? Please explain and support explanations with data and analysis where appropriate.

3. What costs would be associated with implementing the proposed circuit breaker modified uptick rule? Please explain. What costs would be associated with implementing the proposed circuit breaker uptick rule? What would be the degree of financial expenditure involved in updating systems in a manner necessary to ensure compliance with each proposed circuit breaker price test rule? Would the expenditure necessary to ensure compliance be primarily an ''up-front'' cost? Would the expenditure necessary to ensure compliance require long-term investment? Please explain. How would the costs of each of the proposed circuit breaker price test rules compare with the costs of permanent short sale price tests such as the proposed modified uptick rule or the proposed uptick rule? Please explain.

4. What technological challenges would be encountered in updating systems to ensure compliance with each of the proposed circuit breaker price test rules on individual securities? Please explain. How long would it take to update systems in a manner that ensured compliance? Please explain. Would either of the proposed circuit breaker price test rules impede the efficient functioning of the equity markets? If so, why? If not, why not? Please explain. Are there any other operational challenges that may arise from implementing either of the proposed circuit breaker price test rules? Please explain. Would the operational challenges presented impede the effectiveness of the proposed circuit breaker modified uptick rule? Please explain. Would the operational challenges presented impede the effectiveness of the proposed circuit breaker uptick rule? Please explain.

5. Are there other short sale price test restrictions, beyond those discussed herein, that should be considered in

combination with proposed circuit breaker price test rules? Please explain.

6. What would be the benefits and costs associated with the proposed exceptions to the proposed circuit breaker modified uptick rule? Please explain. What would be the benefits and costs associated with the proposed exceptions to the proposed circuit breaker uptick rule? Please explain.

7. What would be the benefits and costs associated with a circuit breaker rule that, when triggered, would prohibit short selling in a particular NMS security on a down-bid unless the short sale is effected at a price that is more than 10% greater than the prior day's closing price? Please explain.

Questions Regarding Proposed Marking Requirements

1. What, if any, additional benefits or costs, beyond those discussed herein, would result from complying with the ''short exempt'' marking requirements under the proposed amendments to Rules 200(g) and 200(g)(2)? What would be the types of additional benefits, and what would be the amounts? What would be the types of additional costs, and what would be the amounts? Who would bear these costs? Should the proposed ''short exempt'' marking requirements be modified in any way to mitigate costs? If so, how?

2. Would there be any operational or compliance concerns associated with the proposed ''short exempt'' marking requirements?

3. What types of costs, if any, would be associated with requiring sell orders be marked ''short exempt'' only if the provisions of paragraph (c) or (d) of the proposed modified uptick rule (or paragraph (c) or (d) of the proposed circuit breaker modified uptick rule) are met? What type of costs, if any, would be associated with requiring sell orders to be marked ''short exempt'' when relying on an exception to the proposed uptick rule (or the proposed circuit breaker uptick rule)? What type of costs, if any, would be associated with requiring sell orders to be marked ''short exempt'' when relying on an exception to the proposed circuit breaker halt rule?

4. What would be a sufficient implementation period for making any systems changes necessary to allow sell orders to be marked ''short exempt''?

5. Please describe any anticipated difficulties in complying with ''short exempt'' marking requirements.

6. The short sales that qualify for the ''broker-dealer'' provision in proposed Rule 201(c) are still subject to the provisions of the proposed modified uptick rule and would be required to be marked as ''short exempt.'' Should these short sales be marked as ''short exempt'' or is another mark more appropriate? What effect, if any, would marking these short sales as ''short exempt'' have on compliance or surveillance relative to another mark? What would be the costs associated with implementing a mark especially for these short sales?

X. Consideration of Burden on Competition and Promotion of Efficiency, Competition, and Capital Formation

Section 3(f) of the Exchange Act requires the Commission, whenever it engages in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, to consider whether the action would promote efficiency, competition, and capital formation.[429] In addition, Section 23(a)(2) of the Exchange Act requires the Commission, when making rules under the Exchange Act, to consider the impact such rules would have on competition.[430] Exchange Act Section 23(a)(2) prohibits the Commission from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.

We believe the proposed amendments might have minimal impact on the promotion of price efficiency and capital formation. The two alternative short sale price tests proposed are designed to allow relatively unrestricted short selling in an advancing market. In addition, the short sale price tests would restrict short selling at successively lower prices and, thereby, might help prevent short selling, including potentially abusive or manipulative short selling, from being used as a tool for driving the market down or from being used to accelerate a declining market by exhausting all remaining bids at one price level, causing successively lower prices to be established by long sellers. Further, by seeking to advance these goals, the two alternative short sale price tests might help restore investor confidence in the securities markets.[431]

If the proposed short sale price test restrictions help address the erosion of investor confidence in our markets, the proposed amendments might help to facilitate and maintain stability in the markets and help ensure that they function efficiently. Bolstering investor confidence in the markets could help to encourage investors to be more willing to invest in the market, thus adding depth and liquidity to the markets and promoting the ability of listed companies to raise capital.

In particular, by proposing to require trading centers to establish, maintain, and enforce written policies and procedures reasonably designed to help prevent the execution or display of a short sale order at a down-bid price, in the case of the proposed modified uptick rule, or prohibiting persons from effecting short sales below the last sale price, in the case of the proposed uptick rule, the proposed short sale price test restrictions might help prevent short selling, including potentially abusive or manipulative short selling, from being used as a tool for driving the market down or from being used to accelerate a declining market by exhausting all remaining bids at one price level, causing successively lower prices to be established by long sellers. By doing so, the proposed amendments might help to facilitate and maintain stability to the markets and help ensure that they function efficiently.

In addition, the proposed short sale price tests might help preserve instant execution and liquidity, by allowing relatively unrestricted short selling in an advancing market. As discussed above, one of the benefits of legitimate short selling is that it provides market liquidity by, for example, adding to the selling interest of stock available to purchasers, and, when sellers are covering their short sales, adding to the buying interest of stock available to sellers. Thus, the proposed short sale price tests are designed to help reduce the potential harm toward the useful market purposes served by short selling by allowing relatively unrestricted short selling in an advancing market.

Moreover, unlike the former short sale price tests (including former Rule 10a–1), the proposed short sale price test restrictions would apply a uniform rule to trades in the same securities that occur in multiple, dispersed, and diverse markets. Under the proposed short sale price test restrictions, all covered securities, wherever traded, would be subject to the same short sale price test. As such, the proposed short sale price test restrictions would not result in the type of disparate short sale regulation that existed under former Rule 10a–1 (in which different price tests were applied in different markets, potentially resulting in confusion, compliance difficulties, regulatory arbitrage, and an un-level playing field

[429] 15 U.S.C. 78c(f).

[430] 15 U.S.C. 78w(a)(2).

[431] *See supra* Section II.C., above (discussing restoring investor confidence).

among market participants).[432] This might help to avoid undermining competition and efficiency in the market.

In addition, the proposed short sale price tests include a number of provisions that are designed to help promote market efficiency and liquidity, while at the same time helping to promote the goals of our proposing at this time short sale price test restrictions and alternative circuit breaker rules. Moreover, the proposed modified uptick rule (and proposed circuit breaker modified uptick rule) is designed to provide trading centers and their customers with flexibility in determining how to handle orders that are not immediately executable or displayable by the trading center because the order is impermissibly priced. For example, if an order is impermissibly priced, a trading center could re-price the order at the lowest permissible price, execute the order immediately if the order is marketable at its new price, or hold it for later execution at its new price or better.[433] As quoted prices change, the proposed rule would allow a trading center to repeatedly re-price and display an order at the lowest permissible price down to the order's original limit order price (or, if a market order, until the order is filled). Permitting a trading center to re-price an impermissibly priced short sale order might help to allow for the more efficient functioning of the markets because trading centers would not have to reject or cancel impermissibly priced orders unless instructed to do so by the trading center's customer submitting the short sale order.

In addition, the proposed circuit breaker rules would be designed to target only those securities that experience severe intraday declines and, therefore, might also help prevent short selling, including potentially abusive or manipulative short selling, from being used as a tool for driving the market down or from being used to accelerate a declining market where needed most. By doing so, the proposed circuit breaker rules might help restore confidence in the securities markets[434] and, in turn, might help stabilize the market for individual securities during times of substantial uncertainty and help ensure that the markets function efficiently. Bolstering investor confidence in the markets might help to encourage investors to be more willing to invest in the market during times of substantial uncertainty, thus adding depth and liquidity to the markets and promoting capital formation.

For example, by halting short selling for the remainder of the trading day following a significant decline in a security's price, we believe the proposed circuit breaker halt rule, in particular, would be designed to provide sufficient time to re-establish equilibrium between buying and selling interests in the individual security in an orderly fashion. It would also be designed to help ensure that market participants have a reasonable opportunity to become aware of, and respond to, a significant decline in a security's price. By providing a pause in short selling resulting from a significant decline in the price of an individual equity security, we believe the proposed circuit breaker halt rule might provide a measure of stability to the markets. However, by allowing short selling to continue with price test restrictions once a circuit breaker was triggered, the proposed circuit breaker price test rules might have less impact on legitimate short selling and normal market activity including price discovery and the provision of liquidity than a circuit breaker with halt on short selling.

By targeting only those securities that experience severe intraday declines, all three proposed circuit breaker rules would be narrowly tailored so that most stocks would not fall under any new short sale restrictions. As such, the proposed circuit breaker rules might help preserve instant execution and liquidity. As discussed above, one of the benefits of legitimate short selling is that it provides market liquidity by, for example, adding to the selling interest of stock available to purchasers, and, when sellers are covering their short sales, adding to the buying interest of stock available to sellers. Thus, the proposed circuit breaker rules are designed to help reduce the potential harm toward the useful market purposes served by short selling by targeting only those securities that experience severe intraday declines.

In addition, the proposed amendment to Rule 200(g)(2) of Regulation SHO to require broker-dealers to mark a sale order as ''short exempt'' if the provisions of paragraph (c) or (d) of the proposed modified uptick rule (or paragraph (c) or (d) of the proposed circuit breaker modified uptick rule) are met, or if the seller is relying on an exception in paragraph (c) of the proposed uptick rule (or paragraph (c) of the proposed circuit breaker uptick rule), or if the seller is relying on an exception in paragraph (c) of the proposed circuit breaker halt rule, could help to promote price efficiency by helping to preserve instant execution and liquidity of such orders.

In addition, we believe that the proposed amendments would not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. We believe the proposed short sale price test restrictions and the proposed circuit breaker rules might help to avoid undermining competition by imposing a uniform price test on all similarly situated entities or individuals subject to the proposed amendments. We recognize, however, that the proposed three-month implementation period for the proposed short sale price test restrictions may not be sufficient for certain smaller broker-dealers and that any potential compliance costs associated with the short sale price test restrictions could likely disproportionately burden these smaller broker-dealers in terms of reduced order flow, thereby impeding competition.[435] However, we believe the proposed circuit breaker halt rule, in particular, might help to avoid undermining competition in that it may require less time and significantly less costs for implementation and compliance with its requirements.[436] In addition, the proposed ''short exempt'' marking requirements would apply to all NMS stocks wherever traded, thereby providing a uniform practice designed to ensure consistency within the equity markets. Moreover, the proposed amendments could help to address any possibility that abusive or manipulative short selling might be contributing to the disruption in the markets and, therefore, could help to address the erosion of investor confidence in the markets.

We request comment on whether the proposed amendments would likely promote efficiency, capital formation, and competition.

[432] *See supra* note 27 (discussing disparate short sale regulation under former Rule 10a–1).

[433] For example, if a trading center received a short sale order priced at $47.00 when the current national best bid in the security was $47.00, but the immediately preceding national best bid was $47.01 (*i.e.,* the current bid was below the previous bid), the trading center could re-price the order at the permissible offer price of $47.01, and display the order for execution at this new limit price.

[434] *See supra* Section II.C. above (discussing restoring investor confidence).

[435] *See* letter from Credit Suisse (discussing need for a much longer implementation period, particularly for smaller broker-dealers, and how compliance costs of a bid or tick test would likely disproportionately burden smaller broker-dealers and impede competition by forcing these smaller broker-dealers to route their flow through a handful of larger broker-dealers).

[436] *See id.*

XI. Consideration of Impact on the Economy

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, or ''SBREFA,'' [437] we must advise the Office of Management and Budget as to whether the proposed regulation constitutes a ''major'' rule. Under SBREFA, a rule is considered ''major'' where, if adopted, it results or is likely to result in:

- An annual effect on the economy of $100 million or more (either in the form of an increase or a decrease);
- A major increase in costs or prices for consumers or individual industries; or
- Significant adverse effect on competition, investment or innovation.

If a rule is ''major,'' its effectiveness will generally be delayed for 60 days pending Congressional review. We request comment on the potential impact of the proposed amendments on the economy on an annual basis. Commenters are requested to provide empirical data and other factual support for their view to the extent possible.

XII. Initial Regulatory Flexibility Analysis

The Commission has prepared an Initial Regulatory Flexibility Analysis (''IRFA''), in accordance with the provisions of the Regulatory Flexibility Act,[438] regarding the proposed amendments to Rules 200(g) and 201 of Regulation SHO under the Exchange Act.

A. Reasons for the Proposed Action

We are proposing to amend Regulation SHO to impose a short sale price test that would restrict the prices at which certain securities may be sold short. We are also proposing as alternatives to a full-time price short sale price test two alternative circuit breaker rules. As discussed above, we believe it is appropriate at this time to examine and seek comment on whether to restore short sale price tests in light of the extreme market conditions that we are currently facing and the resulting deterioration in investor confidence.

We are proposing two alternative short sale price tests. The first test would be the proposed modified uptick rule that would be based on the national best bid. The second test would be the proposed uptick rule that would be a modernized version of the tick test under former Rule 10a–1, and would be based on a last sale price. We are also proposing, as alternatives to a full-time short sale price test, circuit breaker rules that would establish limitations on short selling in a particular security during severe market declines in the price of that security. The proposed circuit breaker halt rule, when triggered by a severe price decline in a particular security, would temporarily prohibit any person from selling short that security during the effectiveness of the circuit breaker.[439] The proposed circuit breaker price test rules, when triggered by a severe market decline in a particular security, would temporarily establish either the proposed modified uptick rule or the proposed uptick rule, as each are described in detail above, for that security.[440]

In addition, we are proposing amendments to Rule 200(g) of Regulation SHO to impose a ''short exempt'' marking requirement and to Rule 200(g)(2) of Regulation SHO to require broker-dealers to mark a sell order ''short exempt'' only if the provisions in paragraph (c) or (d) of the proposed modified uptick rule (or paragraph (c) or (d) of the proposed circuit breaker modified uptick rule) are met, or if a seller is relying on an exception in paragraph (c) of the proposed uptick rule (or paragraph (c) of the proposed circuit breaker uptick rule), or if a seller is relying on an exception in paragraph (c) of the proposed circuit breaker halt rule.

B. Objectives

The two alternative short sale price tests proposed are designed to allow relatively unrestricted short selling in an advancing market. In addition, the short sale price tests are designed to restrict short selling at successively lower prices and, thereby, might help prevent short selling, including potentially abusive or manipulative short selling, from being used as a tool for driving the market down or from being used to accelerate a declining market by exhausting all remaining bids at one price level, causing successively lower prices to be established by long sellers. Further, by seeking to advance these goals, the two alternative short sale price tests would also be designed to help restore investor confidence in the securities markets.

Moreover, the proposed alternative circuit breaker rules would be designed to target only those securities that experience severe intraday declines and, therefore, might also help prevent short selling, including potentially abusive or manipulative short selling, from being used as a tool for driving the market down or from being used to accelerate a declining market when needed most.

C. Legal Basis

Pursuant to the Exchange Act and particularly, Sections 2, 3(b), 6, 9(h), 10, 11A, 15, 15A, 17, 19, 23(a), and 36 thereof, 15 U.S.C. 78b, 78c(b), 78(f), 78i(h), 78j, 78k–1, 78o, 78o–3, 78q, 78s, 78w(a), and 78mm the Commission is proposing amendments to §§ 242.200 and 242.201 of Regulation SHO.

D. Small Entities Subject to the Proposed Amendments

The proposed modified uptick rule and proposed circuit breaker modified uptick rule would require each trading center to establish, maintain, and enforce written policies and procedures reasonably designed to prevent the execution or display of a short sale order at a down-bid price.[441] A ''trading center'' is defined as ''a national securities exchange or national securities association that operates an SRO trading facility, an alternative trading system, an exchange market maker, an OTC market maker, or any other broker-dealer that executes orders internally by trading as principal or crossing orders as agent.'' [442]

Rule 0–10(e) under the Exchange Act provides that the term ''small business'' or ''small organization,'' when referring to an exchange, means any exchange that: (i) Has been exempted from the reporting requirements of Rule 601 under the Exchange Act; [443] and (ii) is not affiliated with any person (other than a natural person) that is not a small business or small organization, as defined by Rule 0–10.[444] No national securities exchanges are small entities because none meet these criteria. There is one national securities association (FINRA) that would be subject to the proposed modified uptick rule. FINRA is not a small entity as defined by 13 CFR 121.201. Thus, the current national securities exchanges and one national securities association that would be subject to the proposed modified uptick rule are not considered ''small entities'' for purposes of the Regulatory Flexibility Act.

The remaining non-SRO trading centers that would be subject to the proposed modified uptick rule or the proposed circuit breaker modified

[437] Public Law 104–121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C. and as a note to 5 U.S.C. 601).

[438] 5 U.S.C. 603.

[439] The proposed circuit breaker halt rule could be imposed in place of, or in addition to, a permanent short sale price restriction rule.

[440] A circuit breaker that triggers a short sale price test rule would be adopted in place of a short sale price test rule.

[441] *See* proposed Rule 201(b)(1).

[442] *See* 17 CFR 242.600(b)(78).

[443] 17 CFR 242.601.

[444] *See* 17 CFR 240.0–10(e) and 13 CFR 121.201.

uptick rule are registered broker-dealers. The Commission has preliminarily determined that approximately 372 broker-dealers registered with the Commission that could meet the proposed definition of a trading center,[445] which includes broker-dealers operating as equity ATSs, broker-dealers registered as market makers or specialists in NMS stocks, and any broker-dealer that is in the business of executing orders internally in NMS stocks. Pursuant to Rule 0–10(c) under the Exchange Act, 17 CFR 240.0–10(c), a broker-dealer is defined as a small entity for purposes of the Exchange Act and the Regulatory Flexibility Act if the broker-dealer had a total capital (net worth plus subordinated liabilities) of less than $500,000 on the date in the prior fiscal year as of which its audited financial statements were prepared, and it is not affiliated with any person (other than a natural person) that is not a small entity.[446] Of these 372 non-SRO trading centers, only five[447] are considered small for purposes of the Regulatory Flexibility Act pursuant to the standards of Rule 0–10(c) under the Exchange Act.

The entities covered by the proposed uptick rule, the proposed circuit breaker uptick rule, the proposed circuit breaker halt rule, and the proposed ''short exempt'' marking requirements, would include small entities that are small broker-dealers, small businesses, and any investor who effected a short sale that qualifies as a small entity. Although we are not aware of data that is available to permit us to quantify every type of small entity covered by the proposed amendments, paragraph (c)(1) of Rule 0–10 under the Exchange Act, as mentioned above, states that the term ''small business'' or ''small organization,'' when referring to a broker-dealer, means a broker-dealer that had total capital (net worth plus subordinated liabilities) of less than $500,000 on the date in the prior fiscal year as of which its audited financial statements were prepared pursuant to § 240.17a–5(d); and is not affiliated with any person (other than a natural person) that is not a small business or small organization. We estimate that as of 2007 there were approximately 896 broker-dealers that qualified as small entities as defined above.[448]

As mentioned above, paragraph (e) of Rule 0–10 under the Exchange Act[449] states that the term ''small business'' or ''small organization,'' when referring to an exchange, means any exchange that: (i) Has been exempted from the reporting requirements of Rule 11Aa3–1 under the Exchange Act; and (ii) is not affiliated with any person (other than a natural person) that is not a small business or small organization, as defined by Rule 0–10. As mentioned above, no U.S. registered exchange is a small entity because none meets these criteria. Any business, however, regardless of industry, could be subject to the proposed uptick rule and the proposed provisions contained in paragraph (c) and (d) of the proposed modified uptick rule (or paragraph (c) or (d) of the proposed circuit breaker modified uptick rule), or the exceptions contained in paragraph (c) of the proposed uptick rule (or paragraph (c) of the proposed circuit breaker uptick rule), or the exceptions contained in paragraph (c) of the proposed circuit breaker halt rule if it effects a short sale. The Commission believes that, except for the broker-dealers discussed above, it is not possible to estimate the number of small entities that would fall under the proposed amendments because we are not aware of data, including the number of investors, who do or will engage in short selling.

E. Projected Reporting, Recordkeeping and Other Compliance Requirements

The proposed amendment may impose some new or additional reporting, recordkeeping, or compliance costs on trading centers and other broker-dealers that are small entities. The proposed modified uptick rule would focus on a trading center's written policies and procedures as the mechanism through which to help prevent the execution or display of short sale orders on a down-bid price. In addition, the proposed modified uptick rule's ''broker-dealer'' provision (and the proposed circuit breaker modified uptick rule's ''broker-dealer'' provision) would include a policies and procedures requirement to help prevent incorrect identification of orders for purposes of the proposed ''broker-dealer'' provision. In order to comply with Regulation NMS when it became effective in 2005, entities were required to modify their systems and surveillance mechanisms in order to comply with the order protection rule's policies and procedures requirement. Thus, the five non-SRO trading centers that would qualify as small entities may already have in place most of the infrastructure necessary to comply with the proposed modified uptick rule (or the proposed circuit breaker modified uptick rule), if adopted.

In addition, in order to implement and comply with former Rule 10a–1, entities were required to modify their systems and surveillance mechanisms. Thus, the small entities that would be subject to the proposed uptick rule (or proposed circuit breaker uptick rule or proposed circuit breaker halt rule) may already be familiar with, and may have retained systems, that would aid in their implementation and compliance with the proposed uptick rule (or proposed circuit breaker uptick rule or proposed circuit breaker halt rule). Small entities, however, may still need to make some modifications to their systems and surveillance mechanisms to implement and ensure compliance with the proposed uptick rule (or proposed circuit breaker uptick rule or proposed circuit breaker halt rule), if adopted.[450]

In addition, the proposed amendment to Rule 200(g)(2) that would require that a sale order be marked ''short exempt'' only if the provisions of proposed Rule 201(c) or (d) of the proposed modified uptick rule (or proposed Rule 201(c) or (d) of the proposed circuit breaker modified uptick rule) are met, or if the seller is relying on an exception from the proposed uptick rule (or the proposed circuit breaker uptick rule), could impose some new or additional reporting, recordkeeping, or compliance costs on broker-dealers that are small entities. We believe, however, that such costs would not be significant. Rule 200(g) currently requires that broker-dealers mark all sell orders of any equity security as either ''long'' or ''short.''[451] Broker-dealers that are small entities should already be familiar with the current marking requirements and should already have in place mechanisms that could be used to comply with the proposed ''short exempt'' marking requirement if adopted.

F. Duplicative, Overlapping, or Conflicting Federal Rules

We believe that there are no rules that duplicate, overlap, or conflict with the proposed amendments to Rules 200(g) and 201 of Regulation SHO.

[445] *See supra* note 10.

[446] 17 CFR 240.0–10(c)(1).

[447] This number was derived from OEA's review of 2007 FOCUS Report filings and discussion with SRO staff.

[448] These numbers are based on OEA's review of 2007 FOCUS Report filings reflecting registered broker-dealers, including introducing broker-dealers. This number does not include broker-dealers that are delinquent on FOCUS Report filings.

[449] 17 CFR 240.0–10(e).

[450] *See* letter from Credit Suisse. *See also supra* note 122 and accompanying text.

[451] *See* 17 CFR 242.200(g).

G. Significant Alternatives

The Regulatory Flexibility Act directs us to consider significant alternatives that would accomplish our stated objective, while minimizing any significant adverse impact on small entities.[452] In connection with the proposed amendments, we considered the following alternatives: (i) Establishing different compliance or reporting requirements or timetables that take into account the resources available to small entities; (ii) clarifying, consolidating, or simplifying compliance and reporting requirements under the rule for small entities; (iii) using performance rather than design standards; and (iv) exempting small entities from coverage of the rule, or any part of the rule.

A primary goal of the proposed amendments is to help restore investor confidence by restricting short selling at successively lower prices and, thereby, help prevent short selling, including potentially abusive or manipulative short selling, from being used as a tool for driving the market down or from being used to accelerate a declining market by exhausting all remaining bids at one price level, while at the same time allowing relatively unrestricted short selling in an advancing market. As such we believe that imposing different compliance requirements, and possibly a different timetable for implementing compliance requirements, for small entities would undermine the goal of restoring investor confidence. It also could create confusion in the market if some sellers were not required to comply. Further, it could undermine the goals of the proposed short sale price test restrictions or the proposed circuit breaker rules because it could provide an avenue for short sellers to evade the proposed amendments. In addition, we have concluded similarly that it is not consistent with the primary goal of the proposals to further clarify, consolidate or simplify the proposals for small entities. Finally, the proposals would impose performance standards rather than design standards.

H. General Request for Comments

We solicit written comments regarding our IRFA analysis. In particular, the Commission seeks comment on the number of small entities that would be affected by the proposed amendments. We request that commenters provide empirical data to quantify the number of small entities that could be affected by the proposed amendments. We request comment on whether the proposed amendments would have any effects that we have not discussed. We also request that commenters describe the nature of any impact on small entities and provide empirical data to support the extent of the impact.

[452] *See* 5 U.S.C. 603(c).

XIII. Additional Request for Comment

In addition to the specific requests for comment found throughout this proposing release, we seek comment generally from all members of the public on all aspects of the proposed amendments to Rules 200(g) and 201 of Regulation SHO. We request that commenters provide empirical data to support their views and arguments related to these proposals. In addition to the questions set forth above, commenters are welcome to offer their views on any other matter raised by the proposed amendments to Regulation SHO. Specifically, are there any other possible restrictions on short selling that the Commission should consider, particularly ones that might be helpful in a severe market decline?

XIV. Statutory Authority

Pursuant to the Exchange Act and, particularly, Sections 2, 3(b), 6, 9(h), 10, 11A, 15, 15A, 17, 19, 23(a), and 36 thereof, 15 U.S.C. 78b, 78c(b), 78(f), 78i(h), 78j, 78k–1, 78o, 78o–3, 78q, 78s, 78w(a), and 78mm the Commission is proposing amendments to §§ 242.200 and 242.201 of Regulation SHO.

XV. Text of the Amendments to Regulation SHO

List of Subjects in 17 CFR Part 242

Brokers, Fraud, Reporting and recordkeeping requirements, Securities.

For the reasons set out in the preamble, Title 17, Chapter II, Part 242, of the Code of Federal Regulations is proposed to be amended as follows.

PART 242—REGULATIONS M, SHO, ATS, AC, AND NMS AND CUSTOMER MARGIN REQUIREMENTS FOR SECURITY FUTURES

1. The authority citation for part 242 continues to read as follows:

Authority: Pursuant to the Exchange Act and, particularly, Sections 2, 3(b), 6, 9(h), 10, 11A, 15, 15A, 17, 19, 23(a), and 36 thereof, 15 U.S.C. 78b, 78c(b), 78(f), 78i(h), 78j, 78k–1, 78o, 78o–3, 78q, 78s, 78w(a), and 78mm the Commission is proposing amendments to §§ 242.200 and 242.201 of Regulation SHO.

Alternative I—Price Tests

A. Modified Uptick Rule

2. Section 242.200 is amended by revising paragraph (g) introductory text and adding paragraph (g)(2) to read as follows:

§ 242.200 Definition of ''short sale'' and marking requirements.

* * * * *

(g) A broker or dealer must mark all sell orders of any equity security as ''long,'' ''short,'' or ''short exempt.''

(1) * * *

(2) A sale order shall be marked ''short exempt'' only if the provisions of § 242.201(c) or (d) are met.

* * * * *

3. Section 242.201 is revised to read as follows:

§ 242.201 Price test.

(a) *Definitions.* For the purposes of this section:

(1) The term *covered security* shall mean any NMS stock as defined in § 242.600(b)(47).

(2) The term *down-bid price* shall mean a price that is less than the current national best bid or, if the last differently priced national best bid was greater than the current national best bid, a price that is less than or equal to the current national best bid.

(3) The term *national best bid* shall have the same meaning as in § 242.600(b)(42).

(4) The term *national market system plan* shall have the same meaning as in § 242.600(b)(43).

(5) The term *odd lot* shall have the same meaning as in § 242.600(b)(49).

(6) The term *riskless principal* shall mean a transaction in which a broker or dealer, after having received an order to buy a security, purchases the security as principal at the same price to satisfy the order to buy or, after having received an order to sell, sells the security as principal at the same price to satisfy the order to sell.

(7) The term *trading center* shall have the same meaning as in § 242.600(b)(78).

(b)(1) A trading center shall establish, maintain, and enforce written policies and procedures reasonably designed to prevent the execution or display of a short sale order of a covered security at a down-bid price. *Provided, however,*

(i) The policies and procedures must be reasonably designed to permit the execution of a displayed short sale order of a covered security by a trading center if, at the time of display of the short sale order, the order was not at a down-bid price.

(ii) The policies and procedures must be reasonably designed to permit the execution or display of a short sale order of a covered security marked ''short exempt'' without regard to whether the order is at a down-bid price.

(2) A trading center shall regularly surveil to ascertain the effectiveness of the policies and procedures required by paragraph (b)(1) of this section and shall take prompt action to remedy deficiencies in such policies and procedures.

(c) A broker or dealer may mark a short sale order of a covered security ''short exempt'' if the broker or dealer that submits the order identifies that the order is not on a down-bid price at the time of submission of the order to the trading center. *Provided, however,*

(1) The broker or dealer that identifies a short sale order of a covered security in accordance with this paragraph must establish, maintain, and enforce written policies and procedures reasonably designed to prevent incorrect identification of orders for purposes of this paragraph; and

(2) The broker or dealer shall regularly surveil to ascertain the effectiveness of the policies and procedures required by paragraph (c) of this section and shall take prompt action to remedy deficiencies in such policies and procedures.

(d) A broker or dealer may mark a short sale order of a covered security ''short exempt'' if the broker or dealer has a reasonable basis to believe:

(1) The short sale order of a covered security is by a person that is deemed to own the covered security pursuant to § 242.200, provided that the person intends to deliver the security as soon as all restrictions on delivery have been removed.

(2) The short sale order of a covered security is by a market maker to off-set customer odd-lot orders or to liquidate an odd-lot position that changes such broker's or dealer's position by no more than a unit of trading.

(3) The short sale order of a covered security is for a good faith account by a person who then owns another security by virtue of which he is, or presently will be, entitled to acquire an equivalent number of securities of the same class as the securities sold; provided such sale, or the purchase which such sale offsets, is effected for the bona fide purpose of profiting from a current difference between the price of the security sold and the security owned and that such right of acquisition was originally attached to or represented by another security or was issued to all the holders of any such securities of the issuer.

(4) The short sale order of a covered security is for a good faith account submitted to profit from a current price difference between a security on a foreign securities market and a security on a securities market subject to the jurisdiction of the United States, provided that the short seller has an offer to buy on a foreign market that allows the seller to immediately cover the short sale at the time it was made. For the purposes of this section, a depository receipt of a security shall be deemed to be the same security as the security represented by such receipt.

(5)(i) The short sale order of a covered security is by an underwriter or member of a syndicate or group participating in the distribution of a security in connection with an over-allotment of securities; or

(ii) Any short sale order with respect to a lay-off sale by an underwriter or member of a syndicate or group in connection with a distribution of securities through a rights or standby underwriting commitment.

(6) The short sale order of a covered security is by a broker or dealer effecting the execution of a customer purchase or the execution of a customer ''long'' sale on a riskless principal basis; *provided, however,* the purchase or sell order must be given the same per-share price at which the broker or dealer sold shares to satisfy the facilitated order, exclusive of any explicitly disclosed markup or markdown, commission equivalent or other fee. In addition, for purposes of this section, a broker or dealer must have written policies and procedures in place to assure that, at a minimum: The customer order was received prior to the offsetting transaction; the offsetting transaction is allocated to a riskless principal or customer account within 60 seconds of execution; and the broker or dealer has supervisory systems in place to produce records that enable the broker or dealer to accurately and readily reconstruct, in a time-sequenced manner, all orders on which a broker or dealer relies pursuant to this exception.

(7) The short sale order is for the sale of a covered security at the volume weighted average price (VWAP) that meets the following criteria:

(i) The VWAP for the covered security is calculated by:

(A) Calculating the values for every regular way trade reported in the consolidated system for the security during the regular trading session, by multiplying each such price by the total number of shares traded at that price;

(B) Compiling an aggregate sum of all values; and

(C) Dividing the aggregate sum by the total number of reported shares for that day in the security.

(ii) The transactions are reported using a special VWAP trade modifier.

(iii) No short sales used to calculate the VWAP are marked ''short exempt.''

(iv) The VWAP matched security:

(A) Qualifies as an ''actively-traded security''; or

(B) The proposed short sale transaction is being conducted as part of a basket transaction of twenty or more securities in which the subject security does not comprise more than five percent of the value of the basket traded.

(v) The transaction is not effected for the purpose of creating actual, or apparent, active trading in or otherwise affecting the price of any security.

(vi) A broker or dealer shall be permitted to act as principal on the contra-side to fill customer short sale orders only if the broker's or dealer's position in the covered security, as committed by the broker or dealer during the pre-opening period of a trading day and aggregated across all of its customers who propose to sell short the same security on a VWAP basis, does not exceed 10% of the covered security's relevant average daily trading volume.

(e) No self-regulatory organization shall have any rule that is not in conformity with, or conflicts with this section.

(f) The provisions of this section shall apply to short sale orders in a covered security at times when a national best bid for the covered security is calculated and disseminated on a current and continuing basis by a plan processor pursuant to an effective national market system plan.

(g) Upon written application or upon its own motion, the Commission may grant an exemption from the provisions of this section, either unconditionally or on specified terms and conditions, to any person or class of persons, to any transaction or class of transactions, or to any security or class of securities to the extent that such exemption is necessary or appropriate, in the public interest, and is consistent with the protection of investors.

B. Uptick Rule

2. Section 242.200 is amended by revising paragraph (g) introductory text and adding paragraph (g)(2) to read as follows:

§ 242.200 Definition of ''short sale'' and marking requirements.

* * * * *

(g) A broker or dealer must mark all sell orders of any equity security as ''long,'' ''short,'' or ''short exempt.''

(1) * * *

(2) A sale order shall be marked ''short exempt'' if the seller is relying on an exception from the price test of § 242.201.

* * * * *

3. Section 242.201 is revised to read as follows:

§ 242.201 Price test.

(a) *Definitions.* For the purposes of this section:

(1) The term *actively traded security* shall have the same meaning as in § 242.101(c)(1).

(2) The term *average daily trading volume* shall have the same meaning as in § 242.100(b).

(3) The term *national market system plan* shall have the same meaning as in § 242.600(b)(43).

(4) The term *covered security* shall mean any NMS stock as defined in § 242.600(b)(47).

(5) The term *odd lot* shall have the same meaning as in § 242.600(b)(49).

(6) The term *riskless principal* shall mean a transaction in which a broker or dealer, after having received an order to buy a security, purchases the security as principal at the same price to satisfy the order to buy or, after having received an order to sell, sells the security as principal at the same price to satisfy the order to sell.

(b) No person shall, for his own account or for the account of any other person, effect a short sale of any covered security, if trades in such security are reported pursuant to an effective national market system plan and information as to such trades is made available in accordance with such plan on a real-time basis to vendors of market transaction information:

(1) Below the price at which the last sale thereof, regular way, was reported pursuant to an effective national market system plan; or

(2) At such price unless such price is above the next preceding different price at which a sale of such security, regular way, was reported pursuant to an effective national market system plan.

(c) The provisions of paragraph (b) of this section shall not apply to:

(1) Any sale by any person of a covered security that the person is deemed to own pursuant to § 242.200, provided that the person intends to deliver the security as soon as all restrictions on delivery have been removed.

(2) Any sale by a broker or dealer of a covered security for an account in which it has no interest, pursuant to an order marked long.

(3) Any sale of a covered security by a market maker to off-set customer odd-lot orders or to liquidate an odd-lot position which changes such broker's or dealer's position by no more than a unit of trading.

(4) Any sale of a covered security for a good faith account by a person who then owns another security by virtue of which he is, or presently will be, entitled to acquire an equivalent number of securities of the same class as the securities sold; provided such sale, or the purchase which such sale offsets, is effected for the bona fide purpose of profiting from a current difference between the price of the security sold and the security owned and that such right of acquisition was originally attached to or represented by another security or was issued to all the holders of any such securities of the issuer.

(5) Any sale of a covered security for a good faith account submitted to profit from a current price difference between a security on a foreign securities market and a security on a securities market subject to the jurisdiction of the United States, provided that the short seller has an offer to buy on a foreign market that allows the seller to immediately cover the short sale at the time it was made. For the purposes of this section, a depository receipt of a security shall be deemed to be the same security as the security represented by such receipt.

(6)(i) Any sale of a covered security by an underwriter or member of a syndicate or group participating in the distribution of a security in connection with an over-allotment of securities; or

(ii) Any lay-off sale by an underwriter or member of a syndicate or group in connection with a distribution of securities through a rights or standby underwriting commitment.

(7) Any sale of a covered security at the volume weighted average price (VWAP) that meets the following criteria:

(i) The VWAP for the covered security is calculated by:

(A) Calculating the values for every regular way trade reported in the consolidated system for the security during the regular trading session, by multiplying each such price by the total number of shares traded at that price;

(B) Compiling an aggregate sum of all values; and

(C) Dividing the aggregate sum by the total number of reported shares for that day in the security.

(ii) The transactions are reported using a special VWAP trade modifier.

(iii) No short sales used to calculate the VWAP are marked ''short exempt'';

(iv) The VWAP matched security:

(A) Qualifies as an ''actively-traded security''; or

(B) The proposed short sale transaction is being conducted as part of a basket transaction of twenty or more securities in which the subject security does not comprise more than five percent of the value of the basket traded.

(v) The transaction is not effected for the purpose of creating actual, or apparent, active trading in or otherwise affecting the price of any security.

(vi) A broker or dealer shall be permitted to act as principal on the contra-side to fill customer short sale orders only if the broker's or dealer's position in the covered security, as committed by the broker or dealer during the pre-opening period of a trading day and aggregated across all of its customers who propose to sell short the same security on a VWAP basis, does not exceed 10% of the covered security's relevant average daily trading volume.

(8) Any sale of a covered security in an electronic trading system that matches buying and selling interest at various times throughout the day that meets the following criteria:

(i) Matches occur at an externally derived price within the existing market and above the current national best bid;

(ii) Sellers and purchasers are not assured of receiving a matching order;

(iii) Sellers and purchasers do not know when a match will occur;

(iv) Persons relying on the exception contained in paragraph (c)(8) of this section shall not be represented in the primary market offer or otherwise influence the primary market bid or offer at the time of the transaction;

(v) Transactions shall not be made for the purpose of creating actual, or apparent, active trading in, or depressing or otherwise manipulating the price of, any security;

(vi) The covered security:

(A) Qualifies as an ''actively-traded security''; or

(B) The proposed short sale transaction is being conducted as part of a basket transaction of twenty or more securities in which the subject security does not comprise more than five percent of the value of the basket traded; and

(vii) During the period of time in which the electronic trading system may match buying and selling interest, there can be no solicitation of customer orders, or any communication with customers that the match has not yet occurred.

(9) Any sale of a covered security by a broker or dealer effecting the execution of a customer purchase or the execution of a customer ''long'' sale on a riskless principal basis; *provided, however,* the purchase or sell order must be given the same per-share price at which the broker or dealer sold shares to satisfy the facilitated order, exclusive of any explicitly disclosed markup or markdown, commission equivalent or other fee. In addition, for purposes of

this section, a broker or dealer must have written policies and procedures in place to assure that, at a minimum: The customer order was received prior to the offsetting transaction; the offsetting transaction is allocated to a riskless principal or customer account within 60 seconds of execution; and the broker or dealer has supervisory systems in place to produce records that enable the broker or dealer to accurately and readily reconstruct, in a time-sequenced manner, all orders on which a broker or dealer relies pursuant to this exception.

(10) Any sale of a covered security (except a sale to a stabilizing bid complying with § 242.104) by a registered specialist or registered exchange market maker for its own account on any exchange with which it is registered for such security, or by a third market maker for its own account over-the-counter:

(i) Effected at a price equal to the most recent offer communicated for the security by such registered specialist, registered exchange market maker or third market maker to an exchange or a national securities association (''association'') pursuant to § 242.602, if such offer, when communicated, was equal to or above the last sale, regular way, reported for such security pursuant to an effective national market system plan. Provided, however,

(ii) That any self-regulatory organization, by rule, may prohibit its registered specialist and registered exchange market makers from availing themselves of the exemption afforded by this paragraph (c)(10) if that self-regulatory organization determines that such action is necessary or appropriate in its market in the public interest or for the protection of investors.

(11) Any sale of a covered security (except a sale to a stabilizing bid complying with § 242.104) by any broker or dealer, for his own account or for the account of any other person, effected at a price equal to the most recent offer communicated by such broker or dealer to an exchange or association pursuant to § 242.602 in an amount less than or equal to the quotation size associated with such offer, if such offer, when communicated, was:

(i) Above the price at which the last sale, regular way, for such security was reported pursuant to an effective national market system plan; or

(ii) At such last sale price, if such last sale price is above the next preceding different price at which a sale of such security, regular way, was reported pursuant to an effective national market system plan.

(12) Any sale of a security by a registered market maker or specialist publishing two-sided quotes to facilitate customer market or marketable limit buy orders.

(d) No self-regulatory organization shall have any rule that is not in conformity with, or conflicts with this section.

(e) The provisions of this section shall apply to short sale orders in a covered security at times when a last sale price for the covered security is calculated and disseminated on a current and continuing basis by a plan processor pursuant to an effective national market system plan.

(f) Upon written application or upon its own motion, the Commission may grant an exemption from the provisions of this section, either unconditionally or on specified terms and conditions, to any person or class of persons, to any transaction or class of transactions, or to any security or class of securities to the extent that such exemption is necessary or appropriate, in the public interest, and is consistent with the protection of investors.

Alternative II—Circuit Breaker Rules

A. Circuit Breaker Halt Rule

2. Section 242.200 is amended by revising paragraph (g) introductory text and adding paragraph (g)(2) to read as follows:

§ 242.200 Definition of ''short sale'' and marking requirements.

* * * * *

(g) A broker or dealer must mark all sell orders of any equity security as ''long,'' ''short,'' or ''short exempt.''

(1) * * *

(2) A sale order shall be marked ''short exempt'' if the seller is relying on an exception from the prohibition against short selling of § 242.201.

* * * * *

3. Section 242.201 is revised to read as follows:

§ 242.201 Circuit breaker.

(a) *Definitions.* For the purposes of this section:

(1) The term *covered security* shall mean any NMS stock as defined in § 242.600(b)(47).

(2) The term *regular trading hours* shall have the same meaning as in § 242.600(b)(64).

(3) The term *national market system plan* shall have the same meaning as in § 242.600(b)(43).

(b) If the price of a covered security, as reported in the consolidated system, decreases by ten percent or more from that covered security's last price reported during regular trading hours the prior day, as reported in the consolidated system, no person shall, for his own account or for the account of any other person, effect a short sale of that covered security, wherever traded, at times when a last sale price for the covered security is calculated and disseminated on a current and continuing basis by a plan processor pursuant to an effective national market system plan, for the remainder of the day.

(c) The provisions of paragraph (b) of this section shall not apply if the decrease in the price of a covered security occurs within thirty minutes from the end of regular trading hours.

(d) The provisions of paragraph (b) of this section shall not apply to:

(1) Any sale of a covered security by a registered market maker, block positioner, or other market maker obligated to quote in the over-the-counter market, in each case that are selling short a covered security as part of bona fide market making in such covered security.

(2) Any sale of a covered security by any person as a result of automatic exercise or assignment of an equity option, or in connection with a futures contract, that is held prior to the trigger event identified in paragraph (b) of this section due to expiration of the option or futures contract.

(3) Any sale of a covered security by any person that is the writer of a call option if the sale is as a result of assignment following exercise by the holder of the call.

(4) Any sale of a covered security by any person that is a market maker, including an over-the-counter market maker, if the sale is part of a bona fide market making and hedging activity related directly to bona fide market making in: (i) Derivative securities based on that covered security; or (ii) exchange traded funds and exchange traded notes of which that covered security is a component.

(5) Any sale of a covered security by any person that is deemed to own the covered security pursuant to § 242.200, provided that the person intends to deliver the security as soon as all restrictions on delivery have been removed.

(e) No self-regulatory organization shall have any rule that is not in conformity with, or conflicts with, this section.

(f) Upon written application or upon its own motion, the Commission may grant an exemption from the provisions of this section, either unconditionally or on specified terms and conditions, to any person or class of persons, to any transaction or class of transactions, or to

any security or class of securities to the extent that such exemption is necessary or appropriate, in the public interest, and is consistent with the protection of investors.

B. Circuit Breaker With Modified Uptick Rule

2. Section 242.200 is amended by revising paragraph (g) introductory text and adding paragraph (g)(2) to read as follows:

§ 242.200 Definition of ''short sale'' and marking requirements.

* * * * *

(g) A broker or dealer must mark all sell orders of any equity security as ''long,'' ''short,'' or ''short exempt.''

(1) * * *

(2) A sale order shall be marked ''short exempt'' only if the provisions of § 242.201(d) or (e) are met.

* * * * *

3. Section 242.201 is revised to read as follows:

§ 242.201 Circuit breaker.

(a) *Definitions.* For the purposes of this section:

(1) The term *covered security* shall mean any NMS stock as defined in § 242.600(b)(47).

(2) The term *regular trading hours* shall have the same meaning as in § 242.600(b)(64).

(3) The term *down-bid price* shall mean a price that is less than the current national best bid or, if the last differently priced national best bid was greater than the current national best bid, a price that is less than or equal to the current national best bid.

(4) The term *national best bid* shall have the same meaning as in § 242.600(b)(42).

(5) The term *national market system plan* shall have the same meaning as in § 242.600(b)(43).

(6) The term *odd lot* shall have the same meaning as in § 242.600(b)(49).

(7) The term *riskless principal* shall mean a transaction in which a broker or dealer, after having received an order to buy a security, purchases the security as principal at the same price to satisfy the order to buy or, after having received an order to sell, sells the security as principal at the same price to satisfy the order to sell.

(8) The term *trading center* shall have the same meaning as in § 242.600(b)(78).

(b) (1) A trading center shall establish, maintain, and enforce written policies and procedures reasonably designed to prevent, when the price of a covered security decreases by ten percent or more from that covered security's last price reported during regular trading hours the prior day, as reported in the consolidated system, the execution or display of a short sale order of that covered security at a down-bid price at times when a national best bid for the covered security is calculated and disseminated on a current and continuing basis by a plan processor pursuant to an effective national market system plan, for the remainder of the day. *Provided, however,*

(i) The policies and procedures must be reasonably designed to permit the execution of a displayed short sale order of a covered security by a trading center if, at the time of display of the short sale order, the order was not at a down-bid price.

(ii) The policies and procedures must be reasonably designed to permit the execution or display of a short sale order of a covered security marked ''short exempt'' without regard to whether the order is at a down-bid price.

(2) A trading center shall regularly surveil to ascertain the effectiveness of the policies and procedures required by paragraph (b)(1) of this section and shall take prompt action to remedy deficiencies in such policies and procedures.

(c) The provisions of paragraph (b) of this section shall not apply if the decrease in the price of a covered security occurs within thirty minutes from the end of regular trading hours.

(d) A broker or dealer may mark a short sale order of a covered security ''short exempt'' if the broker or dealer that submits the order identifies that the order is not on a down-bid price at the time of submission of the order to the trading center. *Provided, however,*

(1) The broker or dealer that identifies a short sale order of a covered security in accordance with this paragraph must establish, maintain, and enforce written policies and procedures reasonably designed to prevent incorrect identification of orders for purposes of this paragraph; and

(2) The broker or dealer shall regularly surveil to ascertain the effectiveness of the policies and procedures required by paragraph (c) of this section and shall take prompt action to remedy deficiencies in such policies and procedures.

(e) A broker or dealer may mark a short sale order of a covered security ''short exempt'' if the broker or dealer has a reasonable basis to believe:

(1) The short sale order of a covered security is by a person that is deemed to own the covered security pursuant to § 242.200, provided that the person intends to deliver the security as soon as all restrictions on delivery have been removed.

(2) The short sale order of a covered security is by a market maker to off-set customer odd-lot orders or to liquidate an odd-lot position that changes such broker's or dealer's position by no more than a unit of trading.

(3) The short sale order of a covered security is for a good faith account by a person who then owns another security by virtue of which he is, or presently will be, entitled to acquire an equivalent number of securities of the same class as the securities sold; provided such sale, or the purchase which such sale offsets, is effected for the bona fide purpose of profiting from a current difference between the price of the security sold and the security owned and that such right of acquisition was originally attached to or represented by another security or was issued to all the holders of any such securities of the issuer.

(4) The short sale order of a covered security is for a good faith account submitted to profit from a current price difference between a security on a foreign securities market and a security on a securities market subject to the jurisdiction of the United States, provided that the short seller has an offer to buy on a foreign market that allows the seller to immediately cover the short sale at the time it was made. For the purposes of this section, a depository receipt of a security shall be deemed to be the same security as the security represented by such receipt.

(5)(i) The short sale order of a covered security is by an underwriter or member of a syndicate or group participating in the distribution of a security in connection with an over-allotment of securities; or

(ii) Any short sale order with respect to a lay-off sale by an underwriter or member of a syndicate or group in connection with a distribution of securities through a rights or standby underwriting commitment.

(6) The short sale order of a covered security is by a broker or dealer effecting the execution of a customer purchase or the execution of a customer ''long'' sale on a riskless principal basis; *provided, however,* the purchase or sell order must be given the same per-share price at which the broker or dealer sold shares to satisfy the facilitated order, exclusive of any explicitly disclosed markup or markdown, commission equivalent or other fee. In addition, for purposes of this section, a broker or dealer must have written policies and procedures in place to assure that, at a minimum: The customer order was received prior to the offsetting transaction; the offsetting

transaction is allocated to a riskless principal or customer account within 60 seconds of execution; and the broker or dealer has supervisory systems in place to produce records that enable the broker or dealer to accurately and readily reconstruct, in a time-sequenced manner, all orders on which a broker or dealer relies pursuant to this exception.

(7) The short sale order is for the sale of a covered security at the volume weighted average price (VWAP) that meets the following criteria:

(i) The VWAP for the covered security is calculated by:

(A) Calculating the values for every regular way trade reported in the consolidated system for the security during the regular trading session, by multiplying each such price by the total number of shares traded at that price;

(B) Compiling an aggregate sum of all values; and

(C) Dividing the aggregate sum by the total number of reported shares for that day in the security.

(ii) The transactions are reported using a special VWAP trade modifier.

(iii) No short sales used to calculate the VWAP are marked ''short exempt.''

(iv) The VWAP matched security:

(A) Qualifies as an ''actively-traded security''; or

(B) The proposed short sale transaction is being conducted as part of a basket transaction of twenty or more securities in which the subject security does not comprise more than five percent of the value of the basket traded.

(v) The transaction is not effected for the purpose of creating actual, or apparent, active trading in or otherwise affecting the price of any security.

(vi) A broker or dealer shall be permitted to act as principal on the contra-side to fill customer short sale orders only if the broker's or dealer's position in the covered security, as committed by the broker or dealer during the pre-opening period of a trading day and aggregated across all of its customers who propose to sell short the same security on a VWAP basis, does not exceed 10% of the covered security's relevant average daily trading volume.

(f) No self-regulatory organization shall have any rule that is not in conformity with, or conflicts with, this section.

(g) Upon written application or upon its own motion, the Commission may grant an exemption from the provisions of this section, either unconditionally or on specified terms and conditions, to any person or class of persons, to any transaction or class of transactions, or to any security or class of securities to the extent that such exemption is necessary or appropriate, in the public interest, and is consistent with the protection of investors.

C. Circuit Breaker With Uptick Rule

2. Section 242.200 is amended by revising paragraph (g) introductory text and adding paragraph (g)(2) to read as follows:

§ 242.200 Definition of ''short sale'' and marking requirements.

* * * * *

(g) A broker or dealer must mark all sell orders of any equity security as ''long,'' ''short,'' or ''short exempt.''

(1) * * *

(2) A sale order shall be marked ''short exempt'' if the seller is relying on an exception from the price test of § 242.201.

* * * * *

3. Section 242.201 is revised to read as follows:

§ 242.201 Circuit breaker.

(a) *Definitions.* For the purposes of this section:

(1) The term *covered security* shall mean any NMS stock as defined in § 242.600(b)(47).

(2) The term *regular trading hours* shall have the same meaning as in § 242.600(b)(64).

(3) The term *actively traded security* shall have the same meaning as in § 242.101(c)(1).

(4) The term *average daily trading volume* shall have the same meaning as in § 242.100(b).

(5) The term *national market system plan* shall have the same meaning as in § 242.600(b)(43).

(6) The term *odd lot* shall have the same meaning as in § 242.600(b)(49).

(7) The term *riskless principal* shall mean a transaction in which a broker or dealer, after having received an order to buy a security, purchases the security as principal at the same price to satisfy the order to buy or, after having received an order to sell, sells the security as principal at the same price to satisfy the order to sell.

(b) If the price of a covered security, as reported in the consolidated system, decreases by ten percent or more from that covered security's last price reported during regular trading hours the prior day, as reported in the consolidated system, no person shall, for his own account or for the account of any other person, effect a short sale of that covered security, wherever traded, at times when a last sale price for the covered security is calculated and disseminated on a current and continuing basis by a plan processor pursuant to an effective national market system plan, for the remainder of the day, if trades in such security are reported pursuant to an effective national market system plan and information as to such trades is made available in accordance with such plan on a real-time basis to vendors of market transaction information:

(1) Below the price at which the last sale thereof, regular way, was reported pursuant to an effective national market system plan; or

(2) At such price unless such price is above the next preceding different price at which a sale of such security, regular way, was reported pursuant to an effective national market system plan.

(c) The provisions of paragraph (b) of this section shall not apply if the decrease in the price of a covered security occurs within thirty minutes from the end of regular trading hours.

(d) The provisions of paragraph (b) of this section shall not apply to:

(1) Any sale by any person of a covered security that the person is deemed to own pursuant to § 242.200, provided that the person intends to deliver the security as soon as all restrictions on delivery have been removed.

(2) Any sale by a broker or dealer of a covered security for an account in which it has no interest, pursuant to an order marked long.

(3) Any sale of a covered security by a market maker to off-set customer odd-lot orders or to liquidate an odd-lot position which changes such broker's or dealer's position by no more than a unit of trading.

(4) Any sale of a covered security for a good faith account by a person who then owns another security by virtue of which he is, or presently will be, entitled to acquire an equivalent number of securities of the same class as the securities sold; provided such sale, or the purchase which such sale offsets, is effected for the bona fide purpose of profiting from a current difference between the price of the security sold and the security owned and that such right of acquisition was originally attached to or represented by another security or was issued to all the holders of any such securities of the issuer.

(5) Any sale of a covered security for a good faith account submitted to profit from a current price difference between a security on a foreign securities market and a security on a securities market subject to the jurisdiction of the United States, provided that the short seller has an offer to buy on a foreign market that allows the seller to immediately cover the short sale at the time it was made. For the purposes of this section, a

depository receipt of a security shall be deemed to be the same security as the security represented by such receipt.

(6)(i) Any sale of a covered security by an underwriter or member of a syndicate or group participating in the distribution of a security in connection with an over-allotment of securities; or

(ii) Any lay-off sale by an underwriter or member of a syndicate or group in connection with a distribution of securities through a rights or standby underwriting commitment.

(7) Any sale of a covered security at the volume weighted average price (VWAP) that meets the following criteria:

(i) The VWAP for the covered security is calculated by:

(A) Calculating the values for every regular way trade reported in the consolidated system for the security during the regular trading session, by multiplying each such price by the total number of shares traded at that price;

(B) Compiling an aggregate sum of all values; and

(C) Dividing the aggregate sum by the total number of reported shares for that day in the security.

(ii) The transactions are reported using a special VWAP trade modifier.

(iii) No short sales used to calculate the VWAP are marked ''short exempt.''

(iv) The VWAP matched security:

(A) Qualifies as an ''actively-traded security''; or

(B) The proposed short sale transaction is being conducted as part of a basket transaction of twenty or more securities in which the subject security does not comprise more than five percent of the value of the basket traded.

(v) The transaction is not effected for the purpose of creating actual, or apparent, active trading in or otherwise affecting the price of any security.

(vi) A broker or dealer shall be permitted to act as principal on the contra-side to fill customer short sale orders only if the broker's or dealer's position in the covered security, as committed by the broker or dealer during the pre-opening period of a trading day and aggregated across all of its customers who propose to sell short the same security on a VWAP basis, does not exceed 10% of the covered security's relevant average daily trading volume.

(8) Any sale of a covered security in an electronic trading system that matches buying and selling interest at various times throughout the day that meets the following criteria:

(i) Matches occur at an externally derived price within the existing market and above the current national best bid;

(ii) Sellers and purchasers are not assured of receiving a matching order;

(iii) Sellers and purchasers do not know when a match will occur;

(iv) Persons relying on the exception contained in paragraph (c)(8) of this section shall not be represented in the primary market offer or otherwise influence the primary market bid or offer at the time of the transaction;

(v) Transactions shall not be made for the purpose of creating actual, or apparent, active trading in, or depressing or otherwise manipulating the price of, any security;

(vi) The covered security:

(A) Qualifies as an ''actively-traded security''; or

(B) The proposed short sale transaction is being conducted as part of a basket transaction of twenty or more securities in which the subject security does not comprise more than five percent of the value of the basket traded; and

(vii) During the period of time in which the electronic trading system may match buying and selling interest, there can be no solicitation of customer orders, or any communication with customers that the match has not yet occurred.

(9) Any sale of a covered security by a broker or dealer effecting the execution of a customer purchase or the execution of a customer ''long'' sale on a riskless principal basis; *provided*, *however*, the purchase or sell order must be given the same per-share price at which the broker or dealer sold shares to satisfy the facilitated order, exclusive of any explicitly disclosed markup or markdown, commission equivalent or other fee. In addition, for purposes of this section, a broker or dealer must have written policies and procedures in place to assure that, at a minimum: the customer order was received prior to the offsetting transaction; the offsetting transaction is allocated to a riskless principal or customer account within 60 seconds of execution; and the broker or dealer has supervisory systems in place to produce records that enable the broker or dealer to accurately and readily reconstruct, in a time-sequenced manner, all orders on which a broker or dealer relies pursuant to this exception.

(10) Any sale of a covered security (except a sale to a stabilizing bid complying with § 242.104) by a registered specialist or registered exchange market maker for its own account on any exchange with which it is registered for such security, or by a third market maker for its own account over-the-counter:

(i) Effected at a price equal to the most recent offer communicated for the security by such registered specialist, registered exchange market maker or third market maker to an exchange or a national securities association (''association'') pursuant to § 242.602, if such offer, when communicated, was equal to or above the last sale, regular way, reported for such security pursuant to an effective national market system plan. Provided, however,

(ii) That any self-regulatory organization, by rule, may prohibit its registered specialist and registered exchange market makers from availing themselves of the exemption afforded by this paragraph (d)(10) if that self-regulatory organization determines that such action is necessary or appropriate in its market in the public interest or for the protection of investors.

(11) Any sale of a covered security (except a sale to a stabilizing bid complying with § 242.104) by any broker or dealer, for his own account or for the account of any other person, effected at a price equal to the most recent offer communicated by such broker or dealer to an exchange or association pursuant to § 242.602 in an amount less than or equal to the quotation size associated with such offer, if such offer, when communicated, was:

(i) Above the price at which the last sale, regular way, for such security was reported pursuant to an effective national market system plan; or

(ii) At such last sale price, if such last sale price is above the next preceding different price at which a sale of such security, regular way, was reported pursuant to an effective national market system plan.

(12) Any sale of a security by a registered market maker or specialist publishing two-sided quotes to facilitate customer market or marketable limit buy orders.

(e) No self-regulatory organization shall have any rule that is not in conformity with, or conflicts with this section.

(f) Upon written application or upon its own motion, the Commission may grant an exemption from the provisions of this section, either unconditionally or on specified terms and conditions, to any person or class of persons, to any transaction or class of transactions, or to any security or class of securities to the extent that such exemption is necessary or appropriate, in the public interest, and is consistent with the protection of investors.

By the Commission.

Dated: April 10, 2009.

Florence E. Harmon,

Deputy Secretary.

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