

## SECURITIES AND EXCHANGE COMMISSION

### 17 CFR Parts 240 and 242

[Release No. 34-55970; File No. S7-21-06]

RIN 3235-AJ76

### Regulation SHO and Rule 10a-1

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Final rule.

**SUMMARY:** The Securities and Exchange Commission ("Commission") is amending the short sale price test under the Securities Exchange Act of 1934 ("Exchange Act"). The amendments are intended to provide a more consistent regulatory environment for short selling by removing restrictions on the execution prices of short sales ("price tests" or "price test restrictions"), as well as prohibiting any self-regulatory organization ("SRO") from having a price test. In addition, the Commission is amending Regulation SHO to remove the requirement that a broker-dealer mark a sell order of an equity security as "short exempt," if the seller is relying on an exception from a price test.

**DATES:** *Effective Date:* July 3, 2007.

*Compliance Date:* July 6, 2007.

#### FOR FURTHER INFORMATION CONTACT:

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**SUPPLEMENTARY INFORMATION:** The Commission is removing Rule 10a-1 [17 CFR 240.10a-1], amending Rule 200 of Regulation SHO [17 CFR 242.200], and adding Rule 201 of Regulation SHO [17 CFR 242.201] under the Exchange Act.

### I. Introduction

#### A. Executive Summary

In December 2006, the Commission proposed amendments to remove the price test of Rule 10a-1 and add Rule 201 of Regulation SHO to provide that no price test, including any price test of any SRO, shall apply to short sales in any security.<sup>1</sup> In addition, we proposed to prohibit any SRO from having a price test.<sup>2</sup> We also proposed to amend Rule 200(g) of Regulation SHO to remove the

requirement that a broker-dealer mark a sell order of an equity security as "short exempt" if the seller is relying on an exception from a price test.<sup>3</sup>

The proposed amendments were designed to modernize and simplify short sale regulation and, at the same time, provide greater regulatory consistency by removing restrictions where they no longer appear effective or necessary.

We received twenty-seven comment letters in response to the proposed amendments. Commenters included individual investors, attorneys, an academic, individual traders, brokerage firms, the New York Stock Exchange LLC ("NYSE"), the International Association of Small Broker-Dealers and Advisors ("IASBDA"), the Securities Traders Association ("STA"), the Managed Funds Association ("MFA"), the Securities Industry and Financial Markets Association ("SIFMA") and the American Stock Exchange LLC ("Amex"). While most commenters supported the Commission's proposals, some expressed concerns regarding particular provisions.<sup>4</sup> We discuss specific comments below in connection with the discussion of the amendments.

After carefully considering the comments, we are adopting the amendments as proposed. In particular, we are removing Rule 10a-1 and adding Rule 201 of Regulation SHO to provide that no price test, including any price test by any SRO, shall apply to short selling in any security. In addition, Rule 201, as adopted, will prohibit any SRO from having a price test.

Because we are adopting our proposal to remove all current price test restrictions, as well as prohibit any SRO from having its own price test, we are also amending Rule 200(g) of Regulation SHO<sup>5</sup> to remove the requirement that a broker-dealer mark a sell order of an equity security as "short exempt" if the seller is relying on an exception from the price test of Rule 10a-1, or any price test of any exchange or national securities association.<sup>6</sup>

<sup>3</sup> See *id.*

<sup>4</sup> A number of comment letters received in response to the proposed amendments discussed issues unrelated to the Proposing Release. We have included a summary of these comment letters in Section IV. Other Comments, below.

<sup>5</sup> 17 CFR 242.200(g).

<sup>6</sup> These amendments affect price tests and related marking requirements only. They do not relate to other provisions of Regulation SHO. We note, however, that on June 13, 2007, at an Open Commission Meeting, we approved amendments to eliminate the "grandfather" provision of Regulation SHO, and proposed amendments to eliminate the options market maker exception of Regulation SHO. These amendments do not alter the amendments to eliminate the grandfather provision, or the proposal to eliminate the options market maker exception.

#### B. Background

The Commission originally adopted Rule 10a-1 in 1938 to restrict short selling in a declining market.<sup>7</sup> Paragraph (a) of Rule 10a-1 covers short sales in securities registered on, or admitted to unlisted trading privileges ("UTP") on, a national securities exchange ("listed securities"), if trades of the security are reported pursuant to an "effective transaction reporting plan" and information regarding such trades is made available in accordance with such plan on a real-time basis to vendors of market transaction information.<sup>8</sup>

Rule 10a-1(a)(1) provides that, subject to certain exceptions, a listed security may be sold short (A) at a price above the price at which the immediately preceding sale was effected (plus tick), or (B) at the last sale price if it is higher than the last different price (zero-plus tick).<sup>9</sup> Short sales are not permitted on minus ticks or zero-minus ticks, subject to narrow exceptions. The operation of these provisions is commonly described as the "tick test."

The core provisions of Rule 10a-1 have remained virtually unchanged since its adoption almost 70 years ago. 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 has added exceptions to Rule 10a-1 and granted numerous written requests for relief from the rule's restrictions.<sup>10</sup> These requests for exemptive relief have increased dramatically in recent years in response to significant developments in the securities markets, such as the increased use of matching systems that execute trades at independently derived prices during random times within specific time intervals and the spread of fully automated markets. Also, decimal pricing increments have substantially reduced the difficulty of short selling on an uptick. In addition, under current price test regulation, different price tests apply to different securities trading in

<sup>7</sup> See Exchange Act Release No. 1548 (Jan. 24, 1938), 3 FR 213 (Jan. 26, 1938).

<sup>8</sup> Rule 10a-1 uses the term "effective transaction reporting plan" as defined in Rule 600 of Regulation NMS (17 CFR 242.600) under the Exchange Act. See 17 CFR 240.10a-1(a)(1)(i).

<sup>9</sup> The last sale price is the price reported pursuant to an effective transaction reporting plan, *i.e.*, the consolidated tape, or to the last sale price reported in a particular marketplace. Under Rule 10a-1, the Commission gives market centers the choice of measuring the tick of the last trade based on executions solely on their own exchange rather than those reported to the consolidated tape. See 17 CFR 240.10a-1(a)(2).

<sup>10</sup> See Proposing Release, 71 FR at 75071-75072 (discussing exceptions to Rule 10a-1 added by the Commission and relief granted by the Commission from the rule's restrictions in recent years).

<sup>1</sup> See Exchange Act Release No. 54891 (Dec. 7, 2006), 71 FR 75068 (Dec. 13, 2006) ("Proposing Release").

<sup>2</sup> See *id.*

different markets and apply generally only to large or more actively-traded securities.<sup>11</sup>

In 2004, we adopted Rule 202T of Regulation SHO,<sup>12</sup> which established procedures for the Commission to temporarily suspend price tests so that the Commission could study the effectiveness of these tests.<sup>13</sup> Pursuant to the process established in Rule 202T of Regulation SHO, we issued an order ("First Pilot Order") creating a one year pilot ("Pilot") temporarily suspending the provisions of Rule 10a-1(a) and any price test of any exchange or national securities association for short sales of certain securities.<sup>14</sup>

<sup>11</sup> Rule 10a-1's tick test is based on the last reported sale and applies to securities listed on a national securities exchange. The NASD's and Nasdaq's bid tests are based on the last bid rather than the last reported sale and apply only to short sales in Nasdaq Global Market securities. See NASD Rule 5100, available at [http://nasd.complinet.com/nasd/display/display.html?rbid=1189&record\\_id=1159007939&element\\_id=1159006014&highlight=5100#r1159007939](http://nasd.complinet.com/nasd/display/display.html?rbid=1189&record_id=1159007939&element_id=1159006014&highlight=5100#r1159007939); Nasdaq Rule 3350, available at [http://nasdaq.complinet.com/nasdaq/display/display.html?rbid=1705&element\\_id=16](http://nasdaq.complinet.com/nasdaq/display/display.html?rbid=1705&element_id=16). Thus, under the current market structure, Nasdaq Global Market securities traded on Nasdaq or the over-the-counter ("OTC") market and reported to an NASD facility are subject to Nasdaq's or the NASD's bid tests; other listed securities traded on an exchange, or otherwise, are subject to Rule 10a-1's tick test. Nasdaq-listed securities traded on exchanges other than Nasdaq are not subject to any short sale price test restrictions. In addition, smaller and more thinly-traded securities, such as Nasdaq Capital Market securities and securities quoted on the OTC bulletin board ("OTCBB") and pink sheets, are not subject to any price test restrictions wherever traded.

<sup>12</sup> 17 CFR 242.202T.

<sup>13</sup> See *id.*; see also Exchange Act Release No. 50103 (July 28, 2004), 69 FR 48008, 48012-48013 (Aug. 6, 2004) ("Regulation SHO Adopting Release").

<sup>14</sup> Exchange Act Release No. 50104 (July 28, 2004), 69 FR 48032 (Aug. 6, 2004). Specifically, the First Pilot Order suspended price tests for: (1) Short sales in the securities identified in Appendix A to the First Pilot Order; (2) short sales in the securities included in the Russell 1000 index effected between 4:15 p.m. EST and the open of the consolidated tape on the following day; and (3) short sales in any security not included in paragraphs (1) and (2) effected in the period between the close of the consolidated tape and the open of the consolidated tape on the following day. In addition, the First Pilot Order provided that the Pilot would commence on January 3, 2005 and terminate on December 31, 2005, and that the Commission might issue further orders affecting the operation of the First Pilot Order. *Id.* at 48033. On November 29, 2004, we 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. Exchange Act Release No. 50747 (Nov. 29, 2004), 69 FR 70480 (Dec. 6, 2004). On April 20, 2006, we issued an order ("Third Pilot Order") extending the termination date of the Pilot to August 6, 2007, the date on which temporary Rule 202T of Regulation SHO expires. Exchange Act Release No. 53684 (April 20, 2006), 71 FR 24765 (April 26, 2006). The purpose of the Third Pilot Order was to maintain the status quo with regard to price tests for Pilot securities while the staff

The Pilot was designed to assist the Commission in assessing whether changes to current short sale regulation are necessary in light of current market practices and the purposes underlying short sale regulation.<sup>15</sup> The Commission stated in the Regulation SHO Adopting Release that conducting a pilot pursuant to Rule 202T would "allow us to obtain data on the impact of short selling in the absence of a price test to assist in determining, among other things, the extent to which a price test is necessary to further the objectives of short sale regulation, to study the effects of relatively unrestricted short selling on market volatility, price efficiency, and liquidity, and to obtain empirical data to help assess whether a price test should be removed, in part or in whole, for some or all securities, or if retained, should be applied to additional securities."<sup>16</sup> As noted in the Regulation SHO Adopting Release, the empirical data from the Pilot was to be obtained and analyzed "as part of [the Commission's] assessment as to whether the price test should be removed or modified, in part or whole, for actively-traded securities or other securities."<sup>17</sup>

Thus, the Commission's Office of Economic Analysis ("OEA") gathered the data made public during the Pilot, analyzed this data and provided the Commission with a summary report on the Pilot.<sup>18</sup> The OEA Staff's Summary Pilot Report examined several aspects of market quality including the overall

completed its analysis of the Pilot data and the Commission conducted any additional short sale rulemaking.

<sup>15</sup> 69 FR at 48032.

<sup>16</sup> Regulation SHO Adopting Release, 69 FR at 48009.

<sup>17</sup> *Id.* at 69 FR at 48013. In the Regulation SHO Adopting Release we noted that "the purpose of the [Pilot] 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." *Id.* at 69 FR at 48010.

<sup>18</sup> See Office of Economic Analysis U.S. Securities and Exchange Commission, *Economic Analysis of the Short Sale Price Restrictions Under the Regulation SHO Pilot* (Feb. 6, 2007) (the "OEA Staff's Summary Pilot Report"), available at <https://www.sec.gov/news/studies/2007/regshopilot020607.pdf>. See also Office of Economic Analysis U.S. Securities and Exchange Commission, *Economic Analysis of the Short Sale Price Restrictions Under the Regulation SHO Pilot* (Sept. 14, 2006) (the "OEA Staff's Draft Summary Pilot Report"), available at [http://www.sec.gov/about/economic/shopilot091506/draft\\_reg\\_sho\\_pilot\\_report.pdf](http://www.sec.gov/about/economic/shopilot091506/draft_reg_sho_pilot_report.pdf). Prior to the publication of the Proposing Release, OEA made available on the Commission's Internet Web site, the OEA Staff's Draft Summary Pilot Report. The conclusions reached in the OEA Staff's Summary Pilot Report do not differ from those in the OEA Staff's Draft Summary Pilot Report.

effect of price tests on short selling, liquidity, volatility and price efficiency. The Pilot data was also designed to allow the Commission and members of the public to examine whether the effects of price tests are similar across stocks.<sup>19</sup>

In addition, the Commission encouraged outside researchers to examine the Pilot. In response to this request, the Commission received four completed studies (the "Academic Studies") from outside researchers that specifically examine the Pilot data.<sup>20</sup> 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 Draft Summary Pilot Report, Academic Studies, and Regulation SHO Roundtable are referred to collectively herein as, the "Pilot Results").<sup>21</sup> The Pilot Results contained a variety of observations, which we considered in determining whether or not to propose removal of current price test restrictions and whether to adopt the amendments today. Generally, the Pilot Results supported removal of current price test restrictions.<sup>22</sup>

Based on our review of the Pilot Results and of the status of current price test restrictions, we proposed to remove Rule 10a-1 and add Rule 201 of Regulation SHO to provide that no price test, including any price test of any SRO, shall apply to short sales in any security. Rule 201 would also prohibit any SRO from having a price test. In addition, because we proposed to remove all current price test restrictions,

<sup>19</sup> In the 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 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 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 publish the information on a monthly basis on their Internet Web sites.

<sup>20</sup> See Karl Diether, Kuan Hui Lee and Ingrid M. Werner, *It's SHO Time! Short-Sale Price-Tests and Market Quality*, June 20, 2006; Gordon J. Alexander and Mark A. Peterson, *The Effect of Price Tests on Trader Behavior and Market Quality: An Analysis of Reg. SHO* (forthcoming in *Journal of Financial Markets*); J. Julie Wu, *Uptick Rule, short selling and price efficiency*, August 14, 2006; Lynn Bai, *The Uptick Rule of Short Sale Regulation—Can it Alleviate Downward Price Pressure from Negative Earnings Shocks?* 2006 ("Bai").

<sup>21</sup> A transcript from the roundtable ("Roundtable Transcript") is available at <http://www.sec.gov/about/economic/shopilottrans091506.pdf>.

<sup>22</sup> See Proposing Release, 71 FR at 75072-75075 (discussing the Pilot Results).

and prohibit any price test by any SRO, we proposed to amend Rule 200(g) of Regulation SHO to remove the requirement that a broker-dealer mark a sell order of an equity security as “short exempt” if the seller is relying on an exception from the price test of Rule 10a–1, or any price test of any exchange or national securities association.

## II. Removal of Price Test Restrictions

We proposed to remove Rule 10a–1 and add Rule 201 of Regulation SHO to provide that no price test, including any price test of any SRO, shall apply to short sales in any security. In addition, we proposed to prohibit any SRO from having a price test. We are adopting the amendments, as proposed.

### A. Comments Summary

The comments on the proposed amendments varied. Most commenters (including individual traders, academics, broker-dealers, MFA, STA, NYSE, and SIFMA) advocated removing all price test restrictions.<sup>23</sup> These commenters believe that price test restrictions are no longer necessary in today’s markets, which are more transparent and where there is real-time regulatory surveillance that can easily monitor for and detect any short sale manipulation.<sup>24</sup> In addition, these commenters noted that market developments, such as technological innovations and decimalization, have transformed the trading landscape since Rule 10a–1 was first adopted and has changed the impact of price test restrictions.<sup>25</sup>

In supporting the proposal, one commenter expressed its view that “short selling enhances market liquidity and contributes to stock pricing efficiency, and thus is an important part of our securities markets, and that the existing restrictions on the execution

prices of short sales \* \* \* inhibit the free-market price discovery mechanism of an efficient market.”<sup>26</sup> In addition, this commenter noted the significant financial, technology and human resources it expends on ensuring compliance with price test restrictions.<sup>27</sup> This commenter believes that the compliance costs and loss of market benefits created by short sales (such as, added liquidity and price efficiency) outweigh any potential or theoretical regulatory benefits of price tests.<sup>28</sup>

In expressing its support for prohibiting SROs from having their own price tests, SIFMA noted that without this prohibition SROs “could feel pressured to maintain a price test as a marketing tool for attracting issuer listings. This would lead to an environment, as exists today, where there would be disparate price tests, or even no price test, depending on the market on which a security trades. Such a result imposes unnecessary compliance costs upon broker-dealers (without also providing real benefits to investors) and leads to regulatory arbitrage.”<sup>29</sup>

Similarly, the STA commented that eliminating price test restrictions and prohibiting SROs from implementing the same would eliminate regulatory arbitrage in short sale regulation and would allow marketplaces to compete with each other on the basis of execution quality, rather than on regulatory disparities, which it believes, would increase public investor confidence in the markets.<sup>30</sup> The NYSE stated its belief that all equity markets should be regulated equally, noting that “[i]t is inappropriate that the federal securities laws, through the application

of Rule 10a–1, requires trading of NYSE-listed securities to be held to a different standard than those listed on other markets.”<sup>31</sup> The NYSE further noted that it believes the “practical effect of the proposed amendments will be to level the playing field in the area of short sales and establish a more consistent and uniform regulatory regime across all markets.”<sup>32</sup>

Two commenters (both individual investors) opposed the proposed amendments noting the need for price tests to prevent “bear raids.”<sup>33</sup> Other commenters (including individual traders and E\*Trade), however, noted that sharp market declines, such as those induced by “bear raids,” are highly unlikely to occur in today’s markets which are characterized by much smaller spreads, higher liquidity, and greater transparency than when the rule was adopted almost 70 years ago.<sup>34</sup>

One commenter, although generally in support of removing all price test restrictions, believes that at some level unrestricted short selling should be collared.<sup>35</sup> This commenter supported having a 10% circuit breaker to prevent panic in the event there is a major market collapse.<sup>36</sup> The NYSE also noted its concern about unrestricted short selling during periods of unusually rapid and large market declines. This commenter 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. Accordingly, the NYSE commented that it believes SROs should be permitted to propose rules to be

<sup>31</sup> NYSE Letter, *supra* note 23.

<sup>32</sup> *Id.*

<sup>33</sup> See, e.g., letter from Jim Ferguson (Dec. 19, 2006); letters from David Patch (Jan. 1, 2007; Jan. 12, 2007) (“Patch Letters”). A “bear raid” involves the active selling of a security short to drive down the security’s price in the hopes of convincing less informed investors of a negative material perception of the security, triggering sell orders. Falling prices could trigger margin calls and possibly forced liquidations of the security, depressing the price further. This unrestricted short selling could exacerbate a declining market in a security by eliminating bids, and causing a further reduction in the price of a security by creating an appearance that the security’s price is falling for fundamental reasons. At the time, 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 & Joel Seligman, *Securities Regulations*, section 8–B–3 (3d ed. 2006).

<sup>34</sup> See, e.g., E\*Trade Letter, *supra* note 23; Giannone Letter, *supra* note 23; Schwarz Letter, *supra* note 23. In addition, we note that panelists at the Regulation SHO Roundtable stated the belief that price test restrictions do not provide protection from bear raids. See Roundtable Transcript.

<sup>35</sup> See Giannone Letter, *supra* note 23.

<sup>36</sup> See *id.*

<sup>23</sup> 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, PhD, 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”).

<sup>24</sup> See, e.g., Giannone Letter, *supra* note 23; E\*TRADE Letter, *supra* note 23; STA Letter, *supra* note 23; UBS Letter, *supra* note 23.

<sup>25</sup> See, e.g., MFA Letter, *supra* note 23.

<sup>26</sup> E\*TRADE Letter, *supra* note 23. See also, MFA Letter, *supra* note 23 (stating that the MFA regards short selling as an essential method by which investors, including fiduciaries managing others’ assets, can manage risk, hedge their portfolios, and reflect their view that the current market price of a security is higher than it should be).

<sup>27</sup> See E\*TRADE Letter, *supra* note 23.

<sup>28</sup> See *id.* See also, UBS Letter, *supra* note 23 (noting that there are substantial programming, implementation, and ongoing compliance costs associated with maintaining price test restrictions).

<sup>29</sup> SIFMA Letter, *supra* note 23. See also, E\*TRADE Letter, *supra* note 23 (commenting that allowing SROs to have their own price tests would increase compliance and systems change costs to market participants, including broker-dealers executing customer short sales). In addition, in its letter, SIFMA commented that allowing SROs to have their own price tests could raise best execution concerns for broker-dealers determining how best to route short sale orders, i.e., in that a broker-dealer would need to consider whether to route short sale orders received to a market that has a price test, as opposed to a market which does not and which could thus perhaps provide a faster execution. See SIFMA Letter, *supra* note 23.

<sup>30</sup> See STA Letter, *supra* note 23.

applied in such situations should they deem it appropriate.<sup>37</sup>

As an alternative to removing all price test restrictions, one commenter suggested extending the Pilot to include more securities to better evaluate the benefits of completely eliminating current price test restrictions.<sup>38</sup> Another commenter, the IASBDA, noted that while it believes that the staff makes a compelling case for the removal of price test restrictions for the Russell 3000 securities, it fails to address whether the issuers of other securities should have some choice in whether they want their stock subject to a price test.<sup>39</sup> IASBDA commented that “[b]y insisting that it must be all or none the staff may unnecessarily force small issuers to accept an environment which is most unkind to their securities.”<sup>40</sup> Furthermore, IASBDA criticized the Pilot for not including OTCBB stocks and other small stocks.<sup>41</sup> This commenter noted that “[t]he Russell 3000 is a broad based index in terms of capitalization but there are roughly 9000 stocks in the publicly reporting universe. The Russell 3000 Index offers investors access to the broad U.S. equity universe representing approximately 98% of the U.S. market, but roughly 33% of individual stocks. The SEC’s Advisory Committee Report on Small Public Companies Final report concluded there were 9,428 companies listed including the OTCBB. Report at p.5.”<sup>42</sup> Thus, IASBDA stated that there may be an argument for phasing in the elimination by starting with the larger stocks and concluding with the OTCBB and smaller segments of the market. IASBDA suggested that this methodology might allow the Commission to learn something from its observance of the large stocks without a tick test.<sup>43</sup>

Similarly, Amex believes that it is premature to remove price tests from smaller securities pending further

analysis.<sup>44</sup> In its comment letter, Amex stated that it has “noted numerous statements in the Proposing Release, the OEA Staff’s Draft Summary Pilot Report, and the Roundtable Transcript that suggest that the impact of eliminating short sale price tests may differ between large capitalization and small capitalization securities. Such a differential impact would obviously be of great concern to the Amex, which has a large concentration of small capitalization issuers.”<sup>45</sup> Thus, Amex commented that while it is not suggesting that price test restrictions be extended to additional securities, nor is it adamantly opposing the ultimate removal of price test restrictions from small capitalization securities to which price tests currently apply, it is advocating additional study before such action is taken in connection with small capitalization securities.<sup>46</sup>

We noted in the Proposing Release that in connection with the Pilot, nine reporting markets have been making public information about short selling transactions,<sup>47</sup> and we requested comment regarding whether it would be in the public interest to request that markets continue to release this information.<sup>48</sup> In response, the NYSE expressed its objection to the Commission continuing to require the markets to collect and make this information publicly available, noting that collecting and producing such information has proven to be costly and time-consuming.<sup>49</sup> The MFA commented that it believes such information should only be made available to law enforcement authorities.<sup>50</sup> Another commenter, however, urged the Commission to work with the SROs to ensure that data similar to that made publicly available

during the Pilot, continues to be available to researchers after the Pilot.<sup>51</sup>

In its letter, the NYSE stated that it believes that “the stated purpose for publicly releasing such data during the pilot—i.e., encouraging independent researchers to study the pilot’s effects—has already been successfully accomplished, as evidenced by the academic studies published and public roundtable held concerning the results of the pilot data.”<sup>52</sup> The NYSE also did not believe that we should request that the SROs submit periodic reports regarding the effects of the removal of price test restrictions at regular intervals, such as on a semi-annual or annual basis, stating that such a requirement, in addition to collecting and making publicly available data on short sale transactions, would “greatly exacerbate costs.”<sup>53</sup>

#### B. Response to Comments

We have carefully considered all the comments we received regarding the proposed amendments. In particular, we note the comments regarding the need for price test restrictions to prevent the use of short selling to drive down the market in “bear raids.” One of the Commission’s stated objectives when it adopted Rule 10a–1 in 1938 was to prevent short sellers from accelerating a declining market by exhausting all remaining bids at one price level, causing successively lower prices to be established by long sellers.<sup>54</sup> In addition, in the Proposing Release, we noted that although short selling serves useful market purposes, such as increasing market liquidity and price efficiency, it also may be used to illegally manipulate stock prices.<sup>55</sup> 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 restrictions. OEA, however, did not find any such association.<sup>56</sup> We also note that although we are removing current price test restrictions, today’s markets are characterized by high levels of transparency and regulatory surveillance. These characteristics greatly reduce the risk of undetected manipulation and permit regulators to

<sup>44</sup> See letter from Claire P. McGrath, Senior Vice President and General Counsel, Amex (Feb. 16, 2007) (“Amex Letter”).

<sup>45</sup> *Id.*

<sup>46</sup> *See id.*

<sup>47</sup> *See* Proposing Release, 71 FR at 75069; *see also, supra* note 19.

<sup>48</sup> *See* Proposing Release, 71 FR at 75077. Specifically, we sought comment regarding whether requesting the markets to continue to release such information would improve transparency of short selling. In addition, we asked whether it would help the Commission monitor the markets for potential abuses if the Commission were to approve the removal of price tests. We also asked for comment regarding how costly it would be for the markets to continue to produce the data and whether there are any less costly alternatives to the current information being released by the markets.

<sup>49</sup> *See* NYSE Letter, *supra* note 23.

<sup>50</sup> *See* MFA Letter, *supra* note 23. The MFA commented that it is “concerned that public transactional short selling data may fuel frivolous issuer lawsuits against market participants with a legitimate but different view of the value of an issuer’s securities.” *Id.*

<sup>51</sup> *See* Angel Letter, *supra* note 23.

<sup>52</sup> NYSE Letter, *supra* note 23.

<sup>53</sup> *See id.*

<sup>54</sup> *See* Exchange Act Release No. 13091 (Dec. 21, 1976), 41 FR 56530 (Dec. 28, 1976).

<sup>55</sup> *See* Proposing Release, 71 FR at 75070.

<sup>56</sup> *See* OEA Staff’s Summary Pilot Report at 56, *supra* note 18.

<sup>37</sup> *See* NYSE Letter, *supra* note 23. The NYSE also noted that it believes that SROs should be permitted to maintain existing rules consistent with this concept, such as NYSE Rule 80(A)(a) (requiring the entry of any index arbitrage order to sell any component stock of the S&P 500 Stock Price Index<sup>SM</sup> with the instruction “sell plus” on any trading day when the NYSE Composite Index<sup>®</sup> declines below its closing value on the prior trading day by at least the “two-percent” value, as calculated according to the methodology found in NYSE Rule 80A.10). *See id.*

<sup>38</sup> *See* Teitelman Letter, *supra* note 23.

<sup>39</sup> *See* letter from Peter Chepucavage, General Counsel, Plexus Consulting, on behalf of International Association of Small Broker-Dealers and Advisors (Dec. 19, 2006) (“IASBDA Letter”).

<sup>40</sup> *Id.*

<sup>41</sup> *Id.*

<sup>42</sup> *Id.*

<sup>43</sup> *See id.*

monitor for the types of activities that current price test restrictions are designed to prevent. In addition, we note that the general anti-fraud and anti-manipulation provisions of the federal securities laws continue to prohibit activity designed to improperly influence the price of a security.<sup>57</sup>

In addition, with respect to comments regarding the Commission allowing SROs to adopt price test restrictions in the event of unusually rapid and large market declines, we have determined not to take such action at this time.<sup>58</sup> We believe that allowing SROs to adopt price test restrictions under such circumstances could undermine a primary objective of the proposed amendments of achieving regulatory uniformity and simplicity.<sup>59</sup> For the same reasons, we do not believe that we should implement a circuit breaker for short sales at this time.

We note, however, that pursuant to Section 36 of the Exchange Act, in the future the Commission could determine that circumstances have arisen that justify the issuance of an exemption from the provisions of Rule 201.<sup>60</sup> Should an SRO request the Commission issue such an exemption in conjunction with the filing of an SRO proposed rule change to establish a price test restriction, when considering any such request, the Commission would consider, among other things, whether the proposed rule change is consistent with the objectives of today's amendments of providing regulatory simplicity and consistency. In addition, to issue an exemption pursuant to Section 36, the Commission would have to find that such an exemption is necessary or appropriate in the public

interest, and is consistent with the protection of investors.<sup>61</sup>

In response to IASBDA's comment regarding allowing issuers to have a choice as to whether or not they want their stock to be subject to a price test, we have determined not to take such action at this time. A primary goal of the amendments is to bring uniformity to, and simplify, short sale regulation. To allow issuers to have a choice as to whether or not their stock is subject to a price test would undermine this primary objective. In addition, we note that in the Proposing Release we specifically requested comment from issuers regarding their views of the impact of the proposed amendments on their securities.<sup>62</sup> We did not, however, receive any comments from issuers.<sup>63</sup>

In addition, with respect to IASBDA's comment regarding the universe of securities subject to the Pilot and, in particular, that the Pilot did not include securities quoted on the OTCBB, we note that the Pilot did not include this class of securities because securities quoted on the OTCBB are not currently subject to any price test restrictions.

Both the IASBDA and Amex suggested removing price tests from larger securities first to allow time to study the impact of the permanent removal of price test restrictions before such action is taken for smaller securities. We do not believe that such an approach would provide new results relevant to smaller securities.<sup>64</sup> As we noted in the Proposing Release, while there is some evidence supporting the application of price test restrictions to smaller securities, the evidence is not strong enough to warrant the continuation of current price test restrictions to any subset of securities.<sup>65</sup> Such continuation would also

undermine a primary goal of these amendments of providing greater uniformity and simplicity to short sale regulation.

In connection with whether we should request that SROs continue to make public information regarding short sale transactions similar to that obtained during the Pilot, we note that the SROs have provided such information during the Pilot at our request so that researchers could provide the Commission with their own empirical analyses of the Pilot.<sup>66</sup> We have determined at this time not to propose to require the SROs to make information similar to that obtained during the Pilot publicly available on a regular basis.

With respect to whether the SROs should submit periodic reports regarding the effects of the removal of price tests, and in response to commenters concerns that traders may have been on "good behavior" during the Pilot,<sup>67</sup> we note that while we believe that current price test restrictions are no longer effective or necessary, we intend to closely monitor for potentially abusive trading activities. We expect that the markets will similarly continue to surveil for trading abuses. To the extent we obtain evidence of possible violations of the federal securities laws, we will pursue investigations and law enforcement actions as warranted.

We have carefully considered the comments and continue to believe that the amendments are appropriate in light of market developments that have occurred in the securities industry since the Commission adopted Rule 10a-1 in 1938, such as decimalization, the increased use of matching systems that execute trades at independently derived prices during random times within specific time intervals, and, most recently, the spread of fully automated markets. We believe the amendments will bring increased uniformity to short sale regulation, level the playing field for market participants, and remove an opportunity for regulatory arbitrage.

In addition, we note that only one commenter questioned the economic evidence supporting the amendments, but we believe that the critique is

<sup>57</sup> See, e.g., Securities Act of 1933 Section 17(a), Exchange Act Section 9(a), 10(b), and 15(c), and Rule 10b-5 thereunder.

<sup>58</sup> See NYSE Letter, *supra* note 23.

<sup>59</sup> We note, however, that Section 12(k)(2) of the Exchange Act provides that the Commission, "in an emergency, may by order summarily take such action to alter, supplement, suspend, or impose requirements or restrictions with respect to any matter or action subject to regulation by the Commission or a self-regulatory organization under the securities laws, as the Commission determines is necessary in the public interest and for the protection of investors (i) to maintain or restore fair and orderly securities markets (other than markets in exempted securities); (ii) to ensure prompt, accurate, and safe clearance and settlement of transactions in securities (other than exempted securities); or (iii) to reduce, eliminate, or prevent the substantial disruption by the emergency of (I) securities markets (other than markets in exempted securities), investment companies, or any other significant portion or segment of such markets, or (II) the transmission or processing of securities transactions (other than transactions in exempted securities)." In addition, SROs may also continue to have rules consistent with the concept of circuit breakers.

<sup>60</sup> See 15 U.S.C. 78mm.

<sup>61</sup> See *id.*

<sup>62</sup> See Proposing Release, 71 FR at 75076.

<sup>63</sup> We note that the IASBDA is an advocacy group for small broker-dealers and advisers (including lawyers and hedge funds).

<sup>64</sup> See IASBDA Letter, *supra* note 39; Amex Letter, *supra* note 44. We note that many smaller or thinly-traded securities, such as Nasdaq Capital Market securities and securities quoted on the OTCBB and pink sheets, are not currently subject to any price test restrictions.

<sup>65</sup> See Proposing Release, 71 FR at 75076. In addition, we note that academics have previously examined short selling in a matched sample of Nasdaq National Market stocks, which were subject to price test restrictions, and Nasdaq SmallCap stocks, which were not, during a period of high volatility and rapidly declining stock prices (September 2000 to August 2001). In this study's sample of 2,275 observations, the study found no significant differences in the overall level of short selling, or the frequency of days with abnormally negative returns and abnormally high short selling. See Michael G. Ferri, Stephen E. Christophe, and James J. Angel, *A short look at bear raids: Testing the bid test*, 2004.

<sup>66</sup> See Regulation SHO Adopting Release, 69 FR at 48009.

<sup>67</sup> For example, in its letter, Amex noted a comment by OEA in the OEA Staff's Draft Summary Pilot Report that it is possible that traders might behave differently if a rule were permanently and completely removed than if it is only temporarily and incompletely removed, and that traders with manipulative intentions might be on good behavior if they believe that heightened scrutiny during the Pilot increases their chances of getting caught. See Amex Letter, *supra* note 44.

inapplicable.<sup>68</sup> The Pilot was designed to assist the Commission in assessing whether changes to current short sale regulation are necessary in light of current market practices and the purposes underlying price test regulation.<sup>69</sup> During the comment period, we received one additional study examining the results of the Pilot.<sup>70</sup> This study found results that are consistent with other Pilot studies previously submitted to, and discussed by, the Commission, which generally found that current price test restrictions do not enhance market quality.<sup>71</sup>

Thus, after carefully considering the comments received, we are adopting the amendments, as proposed.

### III. Removal of "Short Exempt" Marking Requirement

Because we proposed to remove Rule 10a-1 and prohibit any SRO from having a price test, we also proposed to amend Rule 200(g) of Regulation SHO<sup>72</sup> to remove the requirement that a broker-dealer mark a sell order of an equity security as "short exempt" if the seller is relying on an exception from the tick test of Rule 10a-1, or any price test of any exchange or national securities association.<sup>73</sup> We are adopting the amendment as proposed.

Rule 200(g) of Regulation SHO provides that a broker-dealer must mark all sell orders of any security as "long," "short," or "short exempt."<sup>74</sup> Further, Rule 200(g)(2) of Regulation SHO provides that a short sale order must be marked "short exempt" if the seller is "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."<sup>75</sup> The "short exempt" marking requirement provides a record that short sellers are availing themselves of the various exceptions to, or exemptions from, the application of the restrictions of Rule 10a-1 or of any price test of any exchange or national securities association.

#### A. Comments Summary

We received five comment letters, from the MFA, STA, UBS, NYSE, and SIFMA in response to the proposed amendment.<sup>76</sup> Generally, the commenters supported the Commission's proposal to remove the 'short exempt' marking requirement.<sup>77</sup>

Although the STA stated that it supports the proposal to remove the "short exempt" marking requirement in Regulation SHO, the STA commented that it believes that securities currently marked "short exempt" pursuant to Rule 203(b)(2)(ii) of Regulation SHO<sup>78</sup> should be marked "long" rather than "short" because marking such orders "short" "does not accurately describe the customer's ownership of the same and could cause confusion and anger from public investors when they receive confirmation of the sale of a security they understood they owned."<sup>79</sup> Similarly, SIFMA commented that its member firms would encourage the

Commission to amend the definition of a "long" sale to include these types of sales "to avoid unintended consequences and mistaken perceptions by issuers and others as to the nature of the sale."<sup>80</sup>

In addition, SIFMA commented that rather than removing the "short exempt" marking requirement, SIFMA firms generally would prefer that the Commission preserve the "short exempt" marking requirement, specifically amending Regulation SHO to indicate that a sale should be marked "short exempt" if effected in reliance on an exception from the "locate" requirement, pursuant to Rule 203(b)(2) of Regulation SHO.<sup>81</sup> According to SIFMA, firms "generally are of the view that preserving "short exempt" marking for such situations should assist their compliance efforts by identifying short sales for which a locate is not required to be obtained."<sup>82</sup>

The MFA and NYSE responded to our request for comment in the Proposing Release regarding whether, in the absence of price test restrictions, the marking of sell orders would continue to need to be transparent to market makers and specialists.<sup>83</sup> Currently, to

<sup>80</sup> SIFMA Letter, *supra* note 23.

<sup>81</sup> *Id.* Rule 203(b)(2) provides an exception from the locate requirement of Rule 203(b)(1) for: "(i) A broker or dealer that has accepted a short sale order from another registered broker or dealer that is required to comply with paragraph (b)(1) of this section, unless the broker or dealer relying on this exception contractually undertook responsibility for compliance with paragraph (b)(1) of this section; (ii) Any 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. If the person has not delivered such security within 35 days after the trade date, the broker-dealer that effected the sale must borrow securities or close out the short position by purchasing securities of like kind and quantity; (iii) Short sales effected by a market maker in connection with bona-fide market making activities in the security for which this exception is claimed; and (iv) Transactions in security futures."

<sup>82</sup> SIFMA Letter, *supra* note 23. SIFMA noted in its letter that, if the Commission decides not to amend the definition of a "long" sale in Rule 200(g) as suggested by SIFMA, it would strongly urge the Commission to continue to allow firms to mark sales "short exempt," in reliance on the exception from the Regulation SHO "locate" requirement in Rule 203(b)(2)(ii) of Regulation SHO. *Id.* UBS also commented that we should retain the "short exempt" marking requirement to "identify certain short sale transactions as exempt from the affirmative determination requirements for regulatory and compliance requirements." UBS Letter, *supra* note 23.

<sup>83</sup> See Proposing Release, 71 FR at 75078. Specifically, in the Proposing Release we stated that: "To facilitate the application of Rule 10a-1, NASD Rule 5100, and Nasdaq Rule 3350, market makers and specialists receive information allowing them to distinguish short sales from other sales. In other words, the information on whether an order

<sup>68</sup> One commenter expressed concern about the methodologies used in the Pilot studies. See Patch Letters, *supra* note 33 (stating that "the methods in which the OEA conducted their analysis (specifically the duration of time) is flawed. Bear raids do not last for months but over days or weeks and such analysis by the OEA, looking over large windows of time without looking at micro trading, is a flawed approach"). But see, OEA Staff's Summary Pilot Report at 9, *supra* note 18 (stating that OEA focused its investigation on price patterns that might indicate manipulative behavior at a daily or intraday frequency). In addition, we note that panelists from the Regulation SHO Roundtable were asked to critique the studies and all panelists generally agreed with the results. See Roundtable Transcript at 49-57, 72-80, *supra* note 21.

<sup>69</sup> 69 FR at 48032. See also, Proposing Release, 71 FR at 75068-75069, 75072-75073 (discussing the Pilot and the Pilot Results).

<sup>70</sup> See Bai, *supra* note 20. See also, OEA Staff's Summary Pilot Report at 85, *supra* note 18.

<sup>71</sup> Bai found that the Pilot had no effect on stock price reactions to negative earnings shocks. See Bai, *supra* note 20. See also, Proposing Release, 71 FR at 75072-75075 (discussing the Pilot Results).

<sup>72</sup> 17 CFR 242.200(g).

<sup>73</sup> Broker-dealers would, however, continue to be required to mark sell orders as either "long" or "short" in compliance with Rule 200(g).

<sup>74</sup> See 17 CFR 242.200(g).

<sup>75</sup> See *id.* at 242.200(g)(2).

<sup>76</sup> See MFA Letter, *supra* note 23; STA Letter, *supra* note 23; UBS Letter, *supra* note 23; NYSE Letter, *supra* note 23; SIFMA Letter, *supra* note 23.

<sup>77</sup> See MFA Letter, *supra* note 23; STA Letter, *supra* note 23; UBS Letter, *supra* note 23. In its letter, the MFA noted that it believes broker-dealers are in the best position to raise compliance issues related to their systems and the "short exempt" marking requirement. Thus, the MFA urged the Commission to carefully consider any compliance concerns raised by broker-dealers in considering this proposal. See MFA Letter, *supra* note 23.

<sup>78</sup> 17 CFR 242.203(b)(2)(ii). Rule 203(b)(2)(ii) of Regulation SHO excepts from the locate requirement of Regulation SHO any sale of a security that a person is deemed to own pursuant to Rule 200 of Regulation SHO, provided that the broker-dealer has been reasonably informed that the person intends to deliver such security as soon as all restrictions on delivery have been removed. If the person has not delivered such security within 35 days after the trade date, the broker-dealer that effected the sale must borrow securities or close out the short position by purchasing securities of like kind and quantity. Such circumstances could include the situation 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. Another situation could be where a customer owns stock that was formerly restricted, but pursuant to Rule 144 under the Securities Act of 1933, the security may be sold without restriction. In connection with the sale of such security, the security may not be capable of being delivered on settlement date due to processing to remove the restricted legend.

<sup>79</sup> STA Letter, *supra* note 23.

facilitate the application of price test restrictions, market makers and specialists receive information allowing them to distinguish short sales from other sales.

In its comment letter, the MFA stated that “[i]n protecting the confidentiality of customer orders and maintaining a level playing field for all market participants, MFA supports the idea of availing order marking information only to brokers preparing order tickets.”<sup>84</sup> The MFA believes that the “best safeguard for maintaining the integrity of order information is by limiting order marking information to those necessary in carrying out compliance functions.”<sup>85</sup>

NYSE, on the other hand, expressed its belief that it is “necessary that the overall short interest in a security, as well as information on whether a particular sell order introduced to the Exchange is long or short, continue to be transparent intra-day to specialists in the securities in which they are registered.”<sup>86</sup> NYSE noted that “[f]or a specialist, making the correct determination regarding the necessity of a dealer transaction at any given moment includes an understanding of the general market conditions in a particular security, including the actual or reasonably anticipated needs of the market. The intra-day short interest position in a security as well as whether particular orders are long or short are critical pieces of information in the overall mix of factors that combine to form the “market” in that security.”<sup>87</sup> The NYSE believes that the absence of such information would result in poorer overall market quality.<sup>88</sup>

#### B. Response to Comments

We have carefully considered all the comments we received. In response to the STA’s and SIFMA’s comments regarding revising the definition of when an order should be marked “long” to include sales of securities excepted from the locate requirement pursuant to Rule 203(b)(2)(ii) of Regulation SHO, we have determined not to take such action at this time. Although these are sales of securities that a person is “deemed to

own” pursuant to Rule 200 of Regulation SHO,<sup>89</sup> the securities will not be delivered in time for settlement of the transaction and, therefore, we believe that such sales are more appropriately marked as “short” rather than “long” sales.<sup>90</sup>

In addition, in response to STA’s comment that the marking of these orders as “short” does not accurately describe the customer’s ownership of the same and could cause confusion and anger from public investors when they receive confirmation of the sale of a security they understood they owned, we note that the order marking requirements are to facilitate the surveillance and monitoring of compliance with other provisions of Regulation SHO, such as the borrowing and delivery requirements for long sales under Rule 203(a),<sup>91</sup> and the locate requirements for short sales under Rule 203(b).<sup>92</sup> Regulation SHO does not require that a broker-dealer reveal an order marking to its customer. Nor do we believe at this time that it is necessary for a customer to receive such information.

In addition, we have determined not to retain the “short exempt” marking requirement or revise the definition of when an order should be marked “short exempt” to include those circumstances in which a short sale is excepted from the locate requirements of Rule 203(b)(2) of Regulation SHO.<sup>93</sup> The “short exempt” marking requirement has only ever applied if the seller is relying on an exception from a price test. It has never applied to sales that do not have to comply with the locate requirement of Regulation SHO.<sup>94</sup> Today’s amendment to remove the “short exempt” marking requirement is necessitated by the fact that we are removing current price test restrictions and prohibiting any SRO from having a price test. Thus, we do not believe that it is appropriate at this time to re-define the order marking requirements of Regulation SHO as suggested by commenters. We will, however,

consider separately whether further action in this area is necessary or warranted.

With respect to the MFA’s and NYSE’s comments regarding the transparency of order markings to market participants other than those broker-dealers with responsibility for compliance with the marking requirements of Regulation SHO, we have determined at this time to not take any action to limit the transparency of order markings in this way.<sup>95</sup> We will continue, however, to review whether further action by the Commission on this matter is necessary or warranted.

After carefully considering the comments received, we are adopting the proposed amendment without modification.

#### IV. Other Comments

We received eight comment letters from individual investors discussing other provisions of Regulation SHO,<sup>96</sup> most notably the grandfather provision of that rule.<sup>97</sup> In addition, these commenters expressed concerns about naked short selling. This release discusses amendments that will affect price tests and related marking requirements only. They do not relate to other provisions of Regulation SHO or naked short selling, which are the subject of other Commission rulemaking.<sup>98</sup>

#### V. Paperwork Reduction Act

The adopted amendments to Regulation SHO impose a “collection of information” within the meaning of the Paperwork Reduction Act of 1995;<sup>99</sup> however, the collection of information is covered by the approved collection for Exchange Act Rule 19b–4.<sup>100</sup> Rule 201(a) of Regulation SHO provides that no price test, including any price test of any SRO, shall apply to short sales in any security. In addition, Rule 201(b) of Regulation SHO prohibits any SRO from having a price test. Thus, to the extent that any SRO currently has a price test,

<sup>95</sup> Currently, which market participants are able to see the marking for a sell order is established by SRO rule and varies among the SROs.

<sup>96</sup> See 17 CFR 242.200 *et seq.*

<sup>97</sup> See letter from Joan Oleary (Jan. 22, 2007); letter from Candice Grant (Jan. 21, 2007); letter from Roland L. Pitts (Dec. 28, 2006); letter from Charles P. Bennett, M.D. (Jan. 18, 2007); letter from Carlos Molina (Jan. 17, 2007); letter from Lars D. Roose (Feb. 11, 2007); letter from Hillary Thomas (Feb. 11, 2007); letter from H. Glenn Bagwell, Jr. (Feb. 12, 2007). These comment letters relate to File No. S7–12–06 regarding proposed amendments to Regulation SHO and were considered in connection with that rulemaking.

<sup>98</sup> See Regulation SHO Amendments Proposing Release, 71 FR 41710; *see also*, supra n.[6].

<sup>99</sup> 44 U.S.C. 3501 *et seq.*

<sup>100</sup> 17 CFR 240.19b–4.

is marked “long,” “short,” or “short exempt” is made transparent to market makers and specialists but not to other market participants or the public. In the absence of price test restrictions, would the marking of sell orders need to be transparent to market makers and specialists? Would there be any systems or market quality costs/benefits associated with not revealing this information to specialists and market makers?”

<sup>84</sup> MFA Letter, *supra* note 23.

<sup>85</sup> *Id.*

<sup>86</sup> NYSE Letter, *supra* note 23.

<sup>87</sup> *Id.*

<sup>88</sup> *See id.*

<sup>89</sup> 17 CFR 242.200(a)–(f).

<sup>90</sup> Regulation SHO provides that an order can only be marked “long” if the seller is deemed to own the security being sold pursuant to paragraphs (a) through (f) of Rule 200 of Regulation SHO and either: (i) The security to be delivered is in the physical possession or control of the broker or dealer; or (ii) It is reasonably expected that the security will be in the physical possession or control of the broker or dealer no later than settlement of the transaction. *See* 17 CFR 242.200(g). Thus, Regulation SHO contemplates that only those sell orders that will be available for delivery on settlement date can be marked “long.”

<sup>91</sup> 17 CFR 242.203(a).

<sup>92</sup> 17 CFR 242.203(b).

<sup>93</sup> 17 CFR 242.203(b)(2).

<sup>94</sup> *See id.*



that SRO is required to amend its rules to comply with these amendments to Regulation SHO. Any such amendments will need to be filed with the Commission as proposed rule changes, pursuant to Section 19(b) of the Exchange Act<sup>101</sup> and Rule 19b-4 thereunder. This collection of information, however, will be collected pursuant to Exchange Act Rule 19b-4 and, therefore, will not be a new collection of information for purposes of the amendments.

## VI. Consideration of Costs and Benefits of Proposed Amendments to Rule 10a-1 and Regulation SHO

The Commission is sensitive to the costs and benefits that result from our rules. Thus, in the Proposing Release, we solicited comments related to the costs and benefits associated with the proposed amendments.<sup>102</sup> We explicitly requested that commenters provide supporting empirical data for any positions advanced. In addition, we specifically requested comment regarding the costs and benefits of unrestricted short selling activity and any costs associated with complying with the proposed amendments, if the Commission were to adopt the proposed amendments. We also requested comment regarding any costs relating to the removal of price test restrictions adopted by the SROs. In addition, we requested 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 proposals for registrants, issuers, investors, brokers or dealers, other securities industry professionals, regulators, and other market participants.

Four commenters, the STA, UBS, SIFMA, and Amex provided comments related to the costs and benefits of the proposed rule amendments.<sup>103</sup> We discuss these comment letters below.

### A. Removal of Price Test Restrictions

#### 1. Benefits

In the Proposing Release, we solicited comment on any benefits that could be realized if the Commission adopts the proposed amendments, including both short-term and long-term benefits. In addition, we solicited comment regarding benefits to market efficiency,

pricing efficiency, market stability, market integrity, and investor protection. Only the STA submitted comments noting benefits of the proposed amendments.<sup>104</sup>

In its comment letter, the STA noted that it does not believe that the proposed amendments would result in higher trading costs or wider spreads.<sup>105</sup> In addition, the STA stated that it believes the proposed amendments would lead to a reduction in surveillance and compliance costs.<sup>106</sup>

We believe that this is an appropriate time to remove existing price test restrictions because current price test regulation is inconsistent across markets, potentially creates an unlevel playing field, allows for regulatory arbitrage and has not kept pace with the types of trading systems and strategies currently used in the marketplace. In addition, today's markets are characterized by high levels of transparency and regulatory surveillance. These characteristics greatly reduce the risk of undetected manipulation and permit regulators to monitor for the types of activities that Rule 10a-1 and other price tests are designed to prevent.

We believe that the removal of current price test restrictions will benefit market participants by providing market participants with the ability to execute short sales in all securities in all market centers without regard to price test restrictions. In addition, market centers will be competing for executions on a level playing field because they will not be affected by the existence or non-existence of price test restrictions.

We also believe that removing all current price test restrictions is preferable to applying different tests in different markets, which can require market participants to apply different rules to different securities depending on which market the trade is executed. Thus, we believe that the amendments will reduce confusion and compliance difficulties for market participants.

We also believe that the amendments will benefit exchanges and other market centers because market participants will no longer be able to select a market on which to execute a short sale based on the applicability of price test restrictions. The amendments will remove a competitive disadvantage purportedly experienced by some market centers because market participants will no longer route orders to avoid application of a market center's price test. Nor will market centers that

do not have a price test be able to use that factor to attract order flow away from market centers that have a price test.

In addition, the amendments will result in benefits associated with systems and surveillance mechanisms because these systems and mechanisms will no longer need to be programmed to account for price test restrictions based on last sale and last bid information. We also note that in the absence of price test restrictions, new staff (compliance personnel, associated persons, etc.) will no longer need to be trained regarding rules relating to price tests. Over the long run, we believe this will likely lead to decreased training and compliance costs for market participants.

We also believe that the amendments will lead to a reduction in costs because market participants and their lawyers, both in-house and outside counsel, will no longer need to make either informal (phone calls) or formal (letters) requests for exemptions from Rule 10a-1.

In addition, we anticipate that the removal of price test restrictions may result in increased price efficiency because prices will be determined by buy and sell interest, without any artificial restraints on short selling.

#### 2. Costs

We recognize that the amendments may result in some costs to market participants. As an aid to evaluating the costs of the proposed amendments, we solicited comment in the Proposing Release. In particular, we sought comment regarding the costs of the proposed amendments to market participants, including broker-dealers and SROs, related to systems changes to computer hardware and software, reprogramming costs, and surveillance and compliance costs, including whether these costs would be incurred on a one-time or ongoing basis.<sup>107</sup> Four commenters, the STA, UBS, SIFMA and Amex submitted comments regarding costs associated with the proposed amendments.<sup>108</sup>

In their comment letters, the STA, UBS and SIFMA noted potential reprogramming costs that market participants may incur if the Commission does not act on the proposed amendments prior to market participants reprogramming their systems in response to the new regulatory framework created by

<sup>101</sup> 15 U.S.C. 78s(b).

<sup>102</sup> See Proposing Release, 71 FR at 75078-75079.

<sup>103</sup> See STA Letter, *supra* note 23; UBS Letter, *supra* note 23; SIFMA Letter, *supra* note 23; Amex Letter, *supra* note 44.

<sup>104</sup> See STA Letter, *supra* note 23.

<sup>105</sup> See *id.*

<sup>106</sup> See *id.*

<sup>107</sup> See Proposing Release, 71 FR at 75079-75080.

<sup>108</sup> See STA Letter, *supra* note 23; UBS Letter, *supra* note 23; SIFMA Letter, *supra* note 23; Amex Letter, *supra* note 44.



Regulation NMS<sup>109</sup> and the desire of investors and other market participants for more automated and efficient trading services.<sup>110</sup> On January 24, 2007, we extended the date for all automated trading centers (both SRO trading facilities and Alternative Display Facility participants) to have fully operational Regulation NMS-compliant trading systems to July 9, 2007 (the "Regulation NMS Compliance Date").<sup>111</sup> In meeting the Regulation NMS Compliance Date, market participants have been developing new systems or modifying existing systems to be Regulation NMS-compliant.

In their comment letters, STA, UBS, and SIFMA urged the Commission to act on the proposed amendments prior to the Regulation NMS Compliance Date.<sup>112</sup> In its letter, STA noted that "[i]f the SEC's proposal is implemented subsequent to the operation of Regulation NMS to certain securities, it will require industry-wide reprogramming of Regulation NMS compliance systems during the infancy of the Rules implementation, a most sensitive time period. As a result, the immediate success of Regulation NMS could be compromised."<sup>113</sup> As discussed in Section IX below, these amendments will be effective immediately upon publication in the **Federal Register**. Thus, market participants will have notice and time prior to the Regulation NMS Compliance Date to reprogram their systems without regard to current price test restrictions.

In its comment letter, Amex stated that "[w]hile it is difficult to predict future trading activities and the resultant need for new or different regulatory programs, [its] best estimate is that there would probably be no material impact on [its] regulatory costs."<sup>114</sup> Amex noted that although staff time and technology resources

would no longer be required to monitor compliance with price tests, surveillance by Amex staff of order marking violations would still be required. In addition, Amex commented that "the absence of a tick test to discourage potential 'bear raids' and other manipulative activities could result in the need to devote additional resources to such regulatory programs than is currently the case."<sup>115</sup>

We believe that costs associated with the amendments will be minimal because the infrastructure necessary to comply with the amendments are, for the most part, already in place. Market participants have needed to establish or modify their systems and surveillance mechanisms to exempt those securities included in the Pilot from all price test restrictions.<sup>116</sup> In addition, any further changes to systems and surveillance mechanisms or procedures will be relatively minor because the amendments will remove all price test restrictions rather than, for example, impose a modified price test. We also believe that market participants will not need to incur costs to purchase new systems, or increase staffing based solely on the implementation of the amendments.

Although we recognize that market participants may incur costs to modify, establish or implement existing or new supervisory and compliance procedures due to the amendments, these costs will be minimal because market participants already have in place supervisory or compliance procedures to monitor for trading activity that current price test restrictions are designed to deter.

We recognize that SROs that have adopted price tests will incur costs associated with removing such price tests. For example, the NASD and Nasdaq have their own bid tests that, under the amendments, will no longer be applicable.<sup>117</sup> In addition, some exchanges have adopted rules in conformity with the provisions of Rule 10a-1, which will no longer be applicable. SROs may incur costs associated with the processes to remove such rules, including filing rule changes

with the Commission, as well as reprogramming systems designed to enforce these rules. Although we requested comment regarding these costs, including costs relating to preparing and filing any necessary rule changes with the Commission,<sup>118</sup> we did not receive any comments.

We also recognize that the amendments may increase transaction costs, decrease quoted depth, and increase intraday price volatility, particularly in small stocks. The Pilot results suggest, however, that these changes are small in magnitude and would not significantly increase costs or reduce liquidity.<sup>119</sup>

## B. Removal of "Short Exempt" Marking Requirement

### 1. Benefits

We are amending Rule 200(g) of Regulation SHO to remove the "short exempt" marking requirement.<sup>120</sup> Rule 200(g)(2) of Regulation SHO provides that a short sale order must be marked "short exempt" if the seller is "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."<sup>121</sup> Thus, because we are removing all current price test restrictions, as well as prohibiting any SRO from having a price test, the "short exempt" marking requirement will no longer be applicable. In addition, we note that removing the "short exempt" marking requirement will promote regulatory simplification because the marking requirement will no longer be applicable.

### 2. Costs

Although we sought public comment on costs, we did not receive any such comments relating to this proposed amendment. We recognize, however, that there may be some costs associated with removing the "short exempt" marking requirement. Some market participants, including broker-dealers and SROs, may have to reprogram systems and update supervisory procedures due to the removal of the "short exempt" marking requirement. Sales of securities previously marked "short exempt," however, will continue to be marked either "long" or "short." Thus, we believe that such costs will be minor.

<sup>109</sup> See Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496 (June 29, 2005).

<sup>110</sup> See STA Letter, *supra* note 23; UBS Letter, *supra* note 23; SIFMA Letter, *supra* note 23.

<sup>111</sup> See Exchange Act Release No. 55160 (Jan. 24, 2007), 72 FR 4202 (Jan. 30, 2007).

<sup>112</sup> See STA Letter, *supra* note 23; UBS Letter, *supra* note 23; SIFMA Letter, *supra* note 23.

<sup>113</sup> STA Letter, *supra* note 23. In addition, in its comment letter, SIFMA urged the Commission to take steps to eliminate price test restrictions prior to the Regulation NMS Compliance Date to alleviate the necessity 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. SIFMA stated that cost estimates for firms to program for such changes varied, from as low as approximately \$200,000 for some firms to as high as \$2 million for others. See SIFMA Letter, *supra* note 23.

<sup>114</sup> Amex Letter, *supra* note 44.

<sup>115</sup> *Id.*

<sup>116</sup> The Pilot exempts a select group of securities from price test restrictions during regular trading hours. Between the close of the consolidated tape and the open of the consolidated tape on the following day, however, all equity securities are exempted from price test restrictions. See 69 FR at 48033.

<sup>117</sup> See NASD Rule 5100, available at [http://nasd.complinet.com/nasd/display/display.html?rbid=1189&record\\_id=1159007939&element\\_id=1159006014&highlight=5100#r1159007939](http://nasd.complinet.com/nasd/display/display.html?rbid=1189&record_id=1159007939&element_id=1159006014&highlight=5100#r1159007939); Nasdaq Rule 3350, available at [http://nasdaq.complinet.com/nasdaq/display/display.html?rbid=1705&element\\_id=16](http://nasdaq.complinet.com/nasdaq/display/display.html?rbid=1705&element_id=16).

<sup>118</sup> See Proposing Release, 71 FR at 75079-75080.

<sup>119</sup> See *id.* at 75072-75075 (discussing the results of the Pilot).

<sup>120</sup> 17 CFR 242.200(g).

<sup>121</sup> See *id.* at § 242.200(g)(2).

## VII. 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 whenever it is required to consider or determine if an action is necessary or appropriate in the public interest, to consider whether the action would promote efficiency, competition, and capital formation.<sup>122</sup> 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.<sup>123</sup> 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.

In the Proposing Release, we solicited comment on the proposed amendments' effects on efficiency, competition, and capital formation. In addition, we requested, but did not receive, comments regarding the impact of the proposed amendments on the economy generally pursuant to the Small Business Regulatory Enforcement Fairness Act of 1996.<sup>124</sup>

We have considered the proposed amendments to Rule 10a-1 and Regulation SHO in light of the standards of Section 23(a)(2) of the Exchange Act and believe the adopted amendments will not impose any burden on competition not necessary or appropriate in furtherance of the Exchange Act.

The amendments will remove the price test restrictions of Rule 10a-1<sup>125</sup> and provide that no price test, including any price test of any SRO, shall apply to short sales in any security. The amendments will also prohibit any SRO from having a price test. In addition, the amendments will remove the "short exempt" marking requirement of Rule 200(g) of Regulation SHO because this marking requirement applies only if the seller is relying on an exception from the tick test of Rule 10a-1 or any short sale price test of any exchange or national securities association.

Current short sale regulation is inconsistent. For example, Rule 10a-1 applies only to short sale transactions in listed securities. The NASD's and Nasdaq's bid tests apply only to Nasdaq Global Market securities. No price tests apply to short sales in Nasdaq Capital

Market securities or securities quoted on the OTCBB or pink sheets. In addition, no price test applies to short sales of Nasdaq Global Market securities executed on exchanges trading Nasdaq securities on a UTP basis, unless the market on which the securities are being traded has adopted its own price test. Moreover, the current exceptions to, and exemptions from, the price tests for a wide range of short selling activities have limited the applicability of the restrictions contained in these rules. The end result is inconsistent short sale regulation of securities, depending on the market where the securities are trading, and the type of short selling activity. Thus, the amendments are intended to promote regulatory simplification and uniformity by no longer permitting the current price test restrictions on short selling.

We believe that the amendments will not harm efficiency because the empirical evidence from the Pilot Results shows that the Pilot did not adversely impact price efficiency. Further, market participants will no longer have to apply different price tests to securities trading in different markets.

In addition, we believe that the amendments will not have an adverse impact on capital formation because the empirical evidence from the Pilot Results shows that the price tests have very little impact on overall market quality and, particularly in large securities, may be harmful to overall market quality.

We believe that the amendments will promote competition among exchanges and other market centers because market participants will no longer be able to select a market on which to execute a short sale based on the applicability of price test restrictions. The amendments will remove a purported competitive disadvantage experienced by some market centers because market participants will no longer route orders to avoid application of a market center's price test. Nor will market centers that do not have a price test be able to use that factor to attract order flow away from market centers that have a price test. Moreover, the amendments will level the playing field for all market participants by requiring that no price test shall apply to any short sale in any security in any market.<sup>126</sup>

<sup>126</sup> Although we recognize there could conceivably be a need in the future for SROs to propose new price test restrictions, in considering whether to approve any such proposals, the Commission would, among other things, determine whether or not such proposals are consistent with the objectives of today's amendments. Additionally,

## VIII. Final Regulatory Flexibility Analysis

The Commission has prepared the Final Regulatory Flexibility Analysis ("FRFA"), in accordance with the provisions of the Regulatory Flexibility Act ("RFA"),<sup>127</sup> regarding the proposed amendments to Rule 10a-1 and Regulation SHO, Rules 200 and 201, under the Exchange Act.

### A. Need for the Amendments

Based on the Pilot Results as well as our review of the status of short sale regulation in the context of the current application of Rule 10a-1 and other price tests, including the exceptions to the current rules and grants of relief from Rule 10a-1 by the Commission for a wide range of short selling activities, we believe it is necessary to remove Rule 10a-1 and to amend Regulation SHO to provide that no price test, including any price test by any SRO, shall apply to short selling in any security. In addition, the amendments will prohibit any SRO from having a price test. These amendments are designed to modernize and simplify short sale regulation in light of current short selling systems and strategies used in the marketplace, while providing greater regulatory consistency to short selling. We are also removing the "short exempt" marking requirement of Regulation SHO because this requirement only applies if a seller is relying on an exception to a price test.

### B. Significant Issues Raised by Public Comment

The Initial Regulatory Flexibility Analysis ("IRFA") appeared in the Proposing Release.<sup>128</sup> We requested comment in the IRFA on the impact the proposed amendments would have on small entities and how to quantify the impact. We received two comment letters generally discussing the impact of the proposed amendments to remove price test restrictions on small issuers,<sup>129</sup> which we discuss below.

in order for an SRO to adopt new price test restrictions pursuant to Section 19(b) of the Exchange Act, an exemption from the provisions of Rule 201 pursuant to Section 36 of the Exchange Act would be necessary.

<sup>127</sup> 5 U.S.C. 604.

<sup>128</sup> See Proposing Release, 71 FR at 75081-75082.

<sup>129</sup> See IASBDA Letter, *supra* note 39; Amex Letter, *supra* note 44. IASBDA expressed concern that the proposed amendments might "unnecessarily force small issuers to accept an environment which is most unkind to their securities." See IASBDA Letter, *supra* note 39. In its letter, Amex advocated for additional study of the effects of price test restrictions on small capitalization securities before the Commission removes such restrictions on these securities. See Amex Letter, *supra* note 44.

<sup>122</sup> 15 U.S.C. 78c(f).

<sup>123</sup> 15 U.S.C. 78w(a)(2).

<sup>124</sup> Pub. L. 104-121, tit. II, 110 Stat. 857 (1996).

<sup>125</sup> 17 CFR 242.10a-1.

### C. Small Entities Subject to the Rule

The entities covered by the amendment will include small broker-dealers, small businesses, and any investor who effects a short sale that qualifies as a small entity. Although it is impossible to quantify every type of small entity that may be able to effect a short sale in a security, Paragraph (c)(1) of Rule 0–10 under the Exchange Act<sup>130</sup> states that the term “small business” or “small organization,” when referring to a broker-dealer, means a broker or 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. In the IRFA in the Proposing Release, we estimated that as of 2005, there were approximately 910 broker-dealers that qualified as small entities as defined above.<sup>131</sup> Presently, we estimate that as of 2006 there are approximately 894 broker-dealers that qualify as small entities, as defined above.<sup>132</sup>

Paragraph (e) of Rule 0–10 under the Exchange Act<sup>133</sup> states that the term “small business” or “small organization,” when referring to an exchange, means any exchange that: (1) Has been exempted from the reporting requirements of Rule 11Aa3–1 under the Exchange Act; and (2) 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. No national securities exchanges are small entities because none meets these criteria. There is one national securities association (NASD) that is subject to these amendments. NASD is not a small entity as defined by 13 CFR 121.201.

Any business, however, regardless of industry, will be subject to the amendments if it effects a short sale. The Commission believes that, except for the broker-dealers discussed above, an estimate of the number of small entities that fall under the amendments is not feasible.

### D. Reporting, Recordkeeping, and Other Compliance Requirements

We recognize that the amendments may impose some new or additional reporting, recordkeeping, or compliance costs on any affected party, including broker-dealers, that are small entities.

As discussed above, three commenters noted potential reprogramming costs that market participants may incur if the Commission does not act on the proposed amendments prior to the Regulation NMS Compliance Date. In meeting the Regulation NMS Compliance Date, market participants have been developing new systems or modifying existing systems to be Regulation NMS-compliant. In their comment letters, STA, UBS, and SIFMA urged the Commission to act on the proposed amendments prior to the Regulation NMS Compliance Date.<sup>134</sup> In its letter, STA noted that “[i]f the SEC’s proposal is implemented subsequent to the operation of Regulation NMS to certain securities, it will require industry-wide re-programming of Regulation NMS compliance systems during the infancy of the Rules implementation, a most sensitive time period. As a result, the immediate success of Regulation NMS could be compromised.”<sup>135</sup> As discussed in Section IX below, these amendments will be effective immediately upon publication in the **Federal Register**. Thus, market participants will have notice and time prior to the Regulation NMS Compliance Date to reprogram their systems without regard to current price test restrictions.

In order to comply with the Pilot when it became effective on May 2, 2005, small entities needed to modify their systems and surveillance mechanisms to exempt those securities included in the Pilot from current price test restrictions. Thus, the systems and surveillance mechanisms required to comply with the amendments are already in place. We believe that any necessary additional systems and surveillance changes will be small because, due to the Pilot, systems are currently programmed to exempt many securities from price test restrictions prior to the close of the consolidated tape and exempt all securities from price test restrictions between the close of the consolidated tape and the open of the consolidated tape on the following day.

We believe that any reprogramming costs or updating of surveillance

mechanisms associated with the removal of the “short exempt” marking requirement will be minimal because sales of securities will continue to be required to be marked either “long” or “short.” The amendments will merely remove an alternative marking requirement.

### E. Agency Action To Minimize the Effect on Small Entities

The RFA directs the Commission to consider significant alternatives that will accomplish the stated objective, while minimizing any significant adverse impact on small entities. Pursuant to Section 3(a) of the RFA,<sup>136</sup> the Commission considered the following types of alternatives in connection with the amendments: (a) The establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities; (b) the clarification, consolidation, or simplification of compliance and reporting requirements under the rule for small entities; (c) the use of performance rather than design standards; and (d) an exemption from coverage of the rule, or any part thereof, for small entities.

The amendments are intended to modernize and simplify price test regulation by removing restrictions on the execution prices of short sales contained in current price tests, such as Rule 10a–1. 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 the amendments. In particular, the request by IASBDA and Amex for a gradual phase-in of the amendments to permit price test restrictions to continue for small securities pending further study, would cause considerable uncertainty, such as how to treat securities that episodically move between the definition of small and large capitalization. Moreover, we do not believe that such an approach would provide new results relevant to smaller securities. As we noted in the Proposing Release, while there is some evidence supporting the application of price test restrictions to smaller securities, the evidence is not strong enough to warrant its continuation in any subset of securities.<sup>137</sup> In addition, we note that many smaller or thinly-traded securities, such as Nasdaq Capital Market securities, and securities

<sup>130</sup> 17 CFR 240.0–10(c)(1).

<sup>131</sup> These numbers are based on OEA’s review of 2005 FOCUS Report filings reflecting registered broker-dealers. This number does not include broker-dealers that are delinquent on FOCUS Report filings.

<sup>132</sup> These numbers are based on OEA’s review of 2006 FOCUS Report filings reflecting registered broker-dealers. This number does not include broker-dealers that are delinquent in their FOCUS Report filings.

<sup>133</sup> 17 CFR 240.0–10(e).

<sup>134</sup> See STA Letter, *supra* note 23; UBS Letter, *supra* note 23; SIFMA Letter, *supra* note 23.

<sup>135</sup> STA Letter, *supra* note 23.

<sup>136</sup> 5 U.S.C. 603(c).

<sup>137</sup> See Proposing Release, 71 FR at 75076. See also, *supra*, note 65 (discussing a prior study by academics of price test restrictions on smaller securities).

quoted on the OTCBB and pink sheets, are not currently subject to any price test restrictions.

Thus, we have concluded that it would be inconsistent with the goal of the amendments to phase-in small capitalization securities or to further clarify, consolidate, or simplify the amendments for small entities. Finally, the amendments will impose performance standards rather than design standards.

## IX. Administrative Procedure Act

Section 553(d) of the Administrative Procedure Act ("APA") generally provides that a substantive rule may not be made effective less than 30 days after notice is published in the **Federal Register**.<sup>138</sup> Two exceptions to the 30-day requirement, among others, are (i) for a substantive rule that relieves a restriction, and (ii) an agency's finding of good cause for providing a shorter effective date.<sup>139</sup>

The amendments will remove all current restrictions on the price at which a security can be sold short. Because the amendments relieve a restriction on short selling, these amendments may be made effective less than 30 days after notice is published in the **Federal Register**.

In addition, we note that a number of commenters to the proposed amendments discussed potential reprogramming costs that market participants may incur if the proposed amendments are not effective prior to the Regulation NMS Compliance Date.<sup>140</sup> In meeting the Regulation NMS Compliance Date, market participants have been developing new systems or modifying existing systems to be Regulation NMS-compliant. Immediate effectiveness of these amendments is necessary to provide market participants with sufficient notice and time prior to the Regulation NMS Compliance Date to reprogram their systems without regard to current price test restrictions.

Specifically, immediate effectiveness of the amendments is expected to alleviate any necessity for market participants to, in the course of instituting programming changes to meet the requirements of Regulation NMS, program systems to comply with price test restrictions, only to be required to reverse such programming shortly thereafter. Absent immediate effectiveness, market participants may expend unnecessary time and resources programming systems to comply with

price test restrictions that are being removed. Thus, the Commission finds that there is good cause for making the amendments effective immediately upon publication in the **Federal Register**.

## X. Statutory Authority and Text of the Amendments

Pursuant to the Exchange Act and, particularly, Sections 2, 3(b), 6, 9(a), 10(a), 11A, 15, 15A, 17, 17A, 23(a) thereof, 15 U.S.C. 78b, 78c(b), 78f, 78i(a), 78j(a), 78k-1, 78o, 78o-3, 78q, 78q-1, 78w(a), the Commission is removing Rule 10a-1, § 240.10a-1, and amending Regulation SHO, §§ 242.200 and 201.

### Text of the Amendments to Rule 10a-1 and Regulation SHO

#### List of Subjects in 17 CFR Parts 240 and 242

Brokers, Fraud, Reporting and recordkeeping requirements, Securities.

■ For the reasons set out in the preamble, Title 17, Chapter II, of the Code of Federal Regulations is amended as follows.

### PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

■ 1. The authority citation for part 240 continues to read in part as follows:

**Authority:** 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78o, 78p, 78q, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, and 7201 *et. seq.*; and 18 U.S.C. 1350, unless otherwise noted.

\* \* \* \* \*

#### § 240.10a [Removed]

■ 2. Section 240.10a-1 is removed and reserved and the undesignated heading preceding the section is removed.

### PART 242—REGULATIONS M, SHO, ATS, AC AND NMS, AND CUSTOMER MARGIN REQUIREMENTS FOR SECURITY FUTURES

■ 3. The authority citation for part 242 continues to read as follows:

**Authority:** 15 U.S.C. 77g, 77q(a), 77s(a), 78b, 78c, 78g(c)(2), 78i(a), 78j, 78k-1(c), 78l, 78m, 78n, 78o(b), 78o(c), 78o(g), 78q(a), 78q(b), 78q(h), 78w(a), 78dd-1, 78mm, 80a-23, 80a-29, and 80a-37.

■ 4. Section 242.200 is amended by revising the introductory text of paragraph (g) and removing and reserving 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" or "short."

\* \* \* \* \*

■ 5. Section 242.201 is added to read as follows:

#### § 242.201 Price test.

(a) No short sale price test, including any short sale price test of any self-regulatory organization, shall apply to short sales in any security.

(b) No self-regulatory organization shall have any rule that is not in conformity with, or conflicts with, paragraph (a) of this section.

Dated: June 28, 2007.

By the Commission.

J. Lynn Taylor,

Assistant Secretary.

[FR Doc. E7-12868 Filed 7-2-07; 8:45 am]

BILLING CODE 8010-01-P

## SOCIAL SECURITY ADMINISTRATION

### 20 CFR Parts 402

[Regulation No. 2; Docket No.—SSA-2007-0020]

RIN 0960-AG46

### Technical Amendments To Correct Cross-References; Correction

**AGENCY:** Social Security Administration.

**ACTION:** Correcting amendments.

**SUMMARY:** This document contains corrections to the final regulations published in the **Federal Register** of Thursday, March 29, 2007 (72 FR 14669). The regulations were intended to correct incorrect cross-references in the CFR.

**DATES:** *Effective Date:* Effective on July 3, 2007.

#### FOR FURTHER INFORMATION CONTACT:

Rosemarie A. Greenwald, Social Insurance Specialist, Office of Regulations, Social Security Administration, 6401 Security Boulevard, Baltimore, MD 21235-6401. Call (410) 966-7813 or TTY 1-800-325-0778 for information about these correcting amendments. For information on eligibility or filing for benefits, call our national toll-free numbers 1-(800)-772-1213 or TTY 1-(800)-325-0778. You may also contact Social Security online at <http://www.socialsecurity.gov/>.

**SUPPLEMENTARY INFORMATION:**

<sup>138</sup> 5 U.S.C. 553(d).

<sup>139</sup> See *id.* at 553(d)(1), 553(d)(3).

<sup>140</sup> See, e.g., STA Letter, *supra* note 23; UBS Letter, *supra* note 23; SIFMA Letter, *supra* note 23.