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SEC Reopens Comment Period for Short Sale Price Test and Proposes "Alternative Uptick Rule"

The Securities and Exchange Commission (SEC) has reopened the comment period for its proposal relative to the imposition of price restrictions or circuit breakers on short sales. The SEC is seeking additional comment on the "alternative uptick rule" which would allow short selling only at a price above the current national best bid such that short selling would occur only at a higher price than the current national best bid. The new comment period ends 30 days after the proposal is published in the Federal Register.

The SEC's initial proposal for short sale restrictions was published on April 20 (the "Original Proposal") and the comment period closed on June 19. The Original Proposal sought comment on two possible approaches to restricting short selling. The first approach was a market-wide price test that would be based either on the current national best bid (called the "proposed modified uptick rule") or on the last sale price (called the "proposed uptick rule"). The SEC's second approach was a proposed circuit breaker that when triggered would impose either (1) a ban on short selling or (2) a price test based on the proposed modified uptick or uptick rules.

The SEC is now soliciting comment on whether the proposed alternative uptick rule would be preferable to the proposed modified uptick or uptick rules. Consistent with the SEC's Original Proposal, the alternative uptick rule is proposed as either a market-wide and permanent price restriction or as a price test imposed once a circuit breaker threshold is triggered. A circuit breaker that would impose the alternative uptick rule would be triggered by an intraday decline in the price of an individual equity security by a set percentage (for example 10, 15 or 20 percent) from the prior day's closing price.

The Proposed Alternative Uptick Rule

As noted above, the alternative uptick rule would allow short selling only at a price above the current national best bid such that short selling would occur only at a higher price than the current national best bid. Importantly, the alternative uptick rule would appear to restrict short selling to a greater extent than the proposed modified uptick and uptick rules. As noted by the SEC in the proposing release, the alternative uptick rule may not allow short sales to get immediate execution, even in an advancing market.

In order to lessen the costs and time of implementation, the proposed alternative uptick rule would not require traders to monitor the sequence of bids because this rule does not reference whether the current national best bid is above or below the previous national best bid. Several commentators have agreed with the SEC that this aspect of the proposed alternative uptick rule could be easier to implement for traders and market venues, and

For more information, please contact one of the Katten Muchin Rosenman LLP attorneys listed below:

Janet M. Angstadt
312.902.5494 / janet.angstadt@kattenlaw.com

Gary N. Distell
212.940.6490 / gary.distell@kattenlaw.com

Daren R. Domina
212.940.6517 / daren.domina@kattenlaw.com

Patricia L. Levy
312.902.5322 / patricia.levy@kattenlaw.com

Ross Pazzol
312.902.5554 / ross.pazzol@kattenlaw.com

James D. Van De Graaff
312.902.5227 / james.vandegraaff@kattenlaw.com

Lance A. Zinman
312.902.5212 / lance.zinman@kattenlaw.com

therefore could reduce any costs incurred in reprogramming their trading systems. The SEC also is requesting comment on the potential benefits and costs to an alternative uptick rule, particularly with respect to the proposal's potential effect on quote depths, spread widths, market liquidity and execution and pricing inefficiencies.

Exceptions to the Proposed Alternative Uptick Rule

The SEC proposes that the alternative uptick rule include exceptions similar to those proposed with respect to the modified uptick rule as discussed in detail in the Original Proposal. If the SEC pursues this approach, the alternative uptick rule could include exceptions for (i) a seller's delay in delivery, (ii) odd lots, (iii) domestic arbitrage, (iv) international arbitrage, (v) over-allotments and lay-off sales, (vi) transactions executed on a VWAP basis, and (vii) riskless principal transactions.

The SEC is requesting comment on the advisability of these exceptions and whether it is important to add a market maker exception. The SEC also is asking for comment on the scope of any market maker exception and the conditions that should be imposed to ensure that any such exception applies only to "bona fide" market making activities.

"Policies and Procedures" Approach or Outright Prohibition

The SEC notes that the proposed alternative uptick rule could be adopted as a "policies and procedures" rule or as an outright prohibition. Under a policies and procedures approach, trading centers would have to adopt policies and procedures reasonably designed to prevent the execution or display of short sales at impermissible prices. An outright prohibition would prohibit any person from effecting short sales at impermissible prices.

In addition to these highlighted topics, the SEC is requesting comment on whether it should adopt any other of the previously proposed alternatives. The SEC has made it clear that all of the options discussed in the Original Proposal, as well as the option for the SEC to refrain from adopting any short sale rules, remain under active consideration.

Click here to read the SEC press release.

Click here to read the proposing release regarding the alternative uptick rule.

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CHARLOTTE CHICAGO IRVING LONDON LOS ANGELES NEW YORK PALO ALTO WASHINGTON, DC