

SEC Adopts Interim Reporting Requirement for Short Sales

November 11, 2008

This FYI is an update of the FYI circulated by Morgan Lewis on October 17, 2008 reflecting additional informal guidance that we understand was provided by the SEC staff to the Managed Funds Association and other groups. To ensure that our clients have the latest developments, we have described these changes in Q&A 11 and have added a new Question and Answer in Q&A 14. We have also updated our responses to reflect the expiration of the transition period.

As a follow-up to the emergency order it issued in September, the Securities and Exchange Commission (SEC) has issued an interim final rule requiring institutional investment managers to file Form SH to report their short sales. The new rule took effect October 18, 2008 and expires on August 1, 2009. While the rule generally codifies the SEC's earlier emergency order (Release 34-58591) and related guidance from the SEC staff, the interim rule and the SEC's release modify certain aspects of the requirements under the emergency order. In particular, the SEC has provided additional time to submit Form SH and has raised the threshold reporting level. On the other hand, managers are now required to report pre-September 22, 2008 short positions.

We have updated our Q&As regarding the Form SH requirements. Differences between the interim rule and the emergency order are indicated by an asterisk in the question title.

The interim final rule (Release 34-58785) mandates that every institutional investment manager that exercises investment discretion over accounts holding Section 13(f) securities, and that has filed or was required to file a Form 13F for the calendar quarter, file a Form SH disclosing specified information about securities sold short during the preceding week. Managers subject to the reporting requirement include both SEC-registered and unregistered managers that exercise investment discretion over \$100 million or more of the broad group of equity securities described in Section 13(f) of the Securities Exchange Act of 1934.

The SEC has asked for comments on the interim rule, which will be due 60 days after the rule is published in the Federal Register.

1. Who must file a Form SH?*

Any institutional investment manager that filed or was required to file a Form 13F in the current calendar quarter (not only those who filed or were required to file a Form 13F for the calendar quarter ended June 30, 2008).

2. What securities must be reported on Form SH?

The manager must report short positions in "13(f) securities" as defined in Rule 13f-1(c), meaning equity securities traded on an exchange or quoted on an automated quotation system.

3. When is Form SH due?*

Form SH is due on the last business day of a calendar week following a calendar week in which short sales were effected.

4. Can I still file using ASCII or HTML?*

No. You must file using XML (tagged data) format for Form SH filings.

5. Am I required to report intraday positions?*

No. Revised Form SH eliminates Columns 5 (value of securities sold short), 7 (largest intraday short position), and 8 (time of day of largest intraday short position).

6. Do I need to report pre–September 22, 2008 short positions?*

Yes, short positions in place before September 22, 2008 must be reported in Columns 5 (start-of-day short position), 6 (number of securities sold short for the day), and 7 (end-of-day short position).

7. Is there a materiality level for reporting short positions, as there is for reporting long positions on Form 13F (fewer than 10,000 shares of an issuer and aggregate fair market value of your holdings in that same issuer is less than \$200,000)?*

Yes, there are two materiality levels—for filing a Form SH, and for reporting particular positions. The same tests are applied to both filing and reporting determinations.

A manager need not file a Form SH if either:

- The manager did not effect any short sales of a Section 13(f) security during the reporting period; or
- On each calendar day during the calendar week, the start-of-day short position, the gross number of securities sold short during the day and the end-of-day short position *each* constitute less than one-quarter of one percent of that class of the issuer's Section 13(f) securities issued and outstanding as reported on the issuer's most recent annual, quarterly, or current report filed with the SEC under Section 13 of the Exchange Act, unless the manager knows or has reason to believe the information contained therein is inaccurate, *and* the fair market value of the start-of-day short position, the gross number of securities sold short during the day, and the end-of-day short position each are less than \$10 million (the "*de minimis* exception").

8. Must a manager report short exposure through options or other derivatives?

No. The manager will, however, be required to report exercises and assignments if the manager borrows the covered securities to cover settlement.

9. If a manager manages two separate accounts, for purposes of determining whether a short sale has occurred, must the two accounts be netted?

No. Rule 200 of Regulation SHO does not require netting across separate accounts for determining the existence of a short sale.

10. For purposes of reporting a short position, when a manager manages two separate accounts, do the two accounts have to be aggregated or netted, even if one account did not effect a short sale?

Although there is no guidance from the SEC or its staff, it should be reasonable to aggregate only those accounts that have a short position for Form SH reporting purposes. This approach would appear to be consistent with the SEC staff's advice that only short positions resulting from short sales need to be reported. Netting with accounts that are not short could result in an underreporting of short positions.

11. Once a report is required, must all short positions be listed even if there is no change from the prior week?

Once a report is required due to a short sale in any security over the *de minimis* threshold, the rule requires reporting of all short positions in 13(f) securities, even if there is no change in the size of that position as compared to positions held during the prior week. We understand that the staff may provide additional guidance regarding whether managers must report an existing position in which all data points remain below the *de minimis* threshold during the reporting week. Until such guidance is provided, it may be prudent for managers to report such positions with an "N/A" or "0" identifier.

12. For each security for which there is a new short sale or closing of a short position, does a report get filed for each day of the week or for just the day on which the change occurred?

A report must be filed for each day of the week, even if there are days on which no change in the size of the short position occurs.

13. Will Form SH be publicly available? Will confidential treatment be available?*

Form SH will not be publicly available. You do not need to file a confidential treatment request, but you should mark your Form SH "NONPUBLIC."

14. Does the new rule impose any additional recordkeeping requirements relating to the processing of short sales?

No. The existing recordkeeping rules will continue to apply. The release requests comments, however, on whether the SEC should impose additional recordkeeping requirements, including requirements imposed directly on short sellers regarding the name of the broker, the number of shares, the price, the issuer name, and the time and date of entry of the order.

If you have any questions concerning these important legal developments or would like copies of any of the documents mentioned, please contact any of the following Morgan Lewis attorneys:

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