



Regulatory Circular RG08-087

To: Members and Member Organizations

From: Regulatory Services Division

Date: July 24, 2008

Re: Record Keeping For The Pre-Borrow Requirement Under The SEC's Amended Emergency Order Enhancing Investor Protections Against "Naked" Short Selling

The SEC's Emergency Order, as amended (the "Order") requires a person to borrow or arrange to borrow the securities identified in Appendix A to the Order ("Appendix A Securities") or otherwise have the Appendix A Securities available to borrow in its inventory prior to effecting a short sale (referred to herein as the "pre-borrow" requirement). The Order provides, among other things, an exception to the pre-borrow requirement for registered market-makers that are selling short as part of bona fide market making and hedging activities in standardized options. Equity market-makers are also eligible for the exception.

For those instances where an exception does not apply and a broker or dealer is required to pre-borrow prior to effecting a short sale in Appendix A Securities, the Order requires documentation to evidence compliance with the pre-borrow requirement. In the SEC's FAQ concerning the Order, the SEC staff also stated that an arrangement to borrow means a bona fide agreement to borrow the security such that the security being borrowed is set aside at the time of the arrangement solely for the person requesting the security. The SEC's FAQ may be found at:

<http://www.sec.gov/divisions/marketreg/emordershortsalesfaq.htm>

To document compliance with the pre-borrow requirement, the Order confirms that broker-dealers may utilize the same processes and procedures developed to document compliance with the "locate" requirement of Regulation SHO. Section 4 of the SEC's Frequently Asked Questions concerning Regulation SHO provides background on documentation required for a locate. FAQ 4.3(C) states that "the rule requires that broker-dealers document, at a minimum, the identity of the source, as well as the fact that the locate was performed prior to, and on the same day that, the broker-dealer effected the short sale." Additionally, the FAQ notes that the rule also requires documentation of the number of shares located and, in circumstances where documenting the specific number of shares located may be problematic for systems reasons, what the broker-dealer must be able to demonstrate upon request of an SRO or SEC staff. The FAQ also

notes that a broker-dealer may obtain an assurance from a customer that such party can obtain securities from another identified source in time to settle the trade. As discussed in more detail in FAQs 4.3(B) and (C), where the broker-dealer is relying on a customer assurance, the broker-dealer must demonstrate, upon request of an SRO or SEC staff, that it confirmed that the customer performed the locate prior to, and on the same day that, the broker-dealer effected the short sale. The broker-dealer may not rely on a pre-existing agreement, such as a standing instruction letter or blanket assurance, with a customer when complying with the locate requirements of the rule, but must obtain the customer's individual assurance prior to, and for, each short sale. This SEC FAQ may be found at:

<http://www.sec.gov/divisions/marketreg/mrfaqregsho1204.htm>

Questions concerning this Circular can be directed to Jim Adams (312) 786-7718 or Bob Gardner (312) 786-7937.

(Updates Information Circulars IC08-115, IC08-120 and IC08-121)