

This provision, currently subparagraph (a)(2) of Rule 10a-1, was added in response to operational difficulties associated with the tick test based on the last trade price reported in a security in the consolidated transaction reporting system.¹⁹⁹ At the time the provision was added, certain SROs asserted that the last trade price in the consolidated system should not be the reference point for the tick test because last trade price data was not available in a timely manner and because the principal exchanges did not have adequate information retrieval systems on their floors to ensure adherence with the short sale rule.²⁰⁰

We believe that this provision would no longer be needed in light of advances in the dissemination of market information and the proposed use of the consolidated bid for the price test. Currently, all participants in the markets have access to a consolidated, real-time stream of quotations for all the exchange and Nasdaq equity securities that would be subject to the bid test.²⁰¹ Further, unlike the tick test, where the sequence of trade prices plays a crucial role in determining when short sales can be effected, the sequence of the bids under the proposed bid test is not a factor in determining the price at which a short sale can be effected; rather, the reference is the best bid at the time of the short sale transaction. We thus believe that the concerns that gave rise to the (a)(2) provision are no longer present.²⁰² As a result, we propose to eliminate the ability of a market to use its own market information for purposes of the bid test of Regulation SHO.

We also propose to eliminate current subparagraph (a)(3) of Rule 10a-1. This subparagraph allows for an adjustment to the sale price of a security after a security goes ex-dividend, ex-right, or ex any other distribution when determining the price at which a short sale may be effected. Specifically, this provision allows for the reduction of all sale prices by the value of the distribution prior to the "ex" date.

¹⁹⁹ See Securities Exchange Act Release No. 11276 (March 5, 1975), 54 FR 12522 (March 19, 1975) (release proposing subparagraph (a)(2) in response to stated operational and other difficulties associated with complying with Rule 10a-1) (Proposing Release); see also Securities Exchange Act Release No. 11468 (June 12, 1975), 40 FR 25442 (June 16, 1975) (adoption of proposed changes adding subparagraph (a)(2)) (Adopting Release).

²⁰⁰ *Id.*

²⁰¹ See, *supra* part IV.B.

²⁰² In adopting subparagraph (a)(2) the Commission noted that the "modernization of exchange facilities may eliminate the need to structure short sale regulation in this manner and that it should be possible ultimately to utilize the kind of uniform rule" originally proposed. See, *supra* n. 199.

Under the proposed bid test, we do not believe (a)(3) is necessary because the last trade price would not be a factor in determining when a short sale can be effected, and the bid would immediately reflect the impact of the corporate action.

Q. Are there any regulatory or operational reasons to allow markets to use their own bid information in regulating short sales under the proposed rule?

Q. Would allowing markets to use their own bid information affect the operation or effectiveness of the proposed rule? If so, how?

Q. Is there any reason to retain the requirements of existing subparagraph (a)(3) of Rule 10a-1, which allows for the adjustment to the sale price of a security after a security goes ex-dividend, ex-right, or ex any other distribution, under the proposed bid test? For example, do exchanges that match opening trades prior to the opening quotes require such a provision?

XIII. Exclusion of Bonds

In 1992 the Commission proposed excluding from the application of Rule 10a-1 transactions in nonconvertible corporate bonds listed and effected on an exchange.²⁰³ This action was in response to a petition for rulemaking by the Amex that paragraph (b) of the Rule be amended to exclude corporate bonds from short sale regulation.²⁰⁴ Amex had noted that while paragraph 10a-1(a) of the Rule is not applied to bonds because transactions in corporate bonds are not required to be reported on a consolidated basis with other markets, bonds are covered under paragraph (b) regulating short sales of other securities on an exchange. According to the Amex, a competitive inequity was thus created between the exchanges and the over-the-counter market, where short selling is not regulated at all.²⁰⁵ Moreover, it was argued that, because the majority of corporate bond transactions occur in the OTC market, it would be difficult for a market participant to effect a manipulation of the primary bond market through short sales on an exchange.

The Commission preliminarily concluded in the release that the application of Rule 10a-1 to bonds

²⁰³ See Securities Exchange Act Release No. 30772 (June 3, 1992), 57 FR 24415 (June 9, 1992).

²⁰⁴ See Letters from Carrie E. Dwyer, Vice President and General Counsel, Amex, to John Wheeler, Secretary, SEC (December 30, 1985 and January 22, 1986); and Letter from Scott L. Noah, Assistant Vice President and General Counsel, Amex, to Jonathan G. Katz, Secretary, SEC (November 22, 1989) (Amex Letters).

²⁰⁵ The Commission noted the fact that the NASD had filed in April of 1992 a proposed rule change to implement its own short sale regulation, however this "bid test" would not relate to OTC transactions in bonds. See, *supra* n. 203 at n. 34.

might impose an unnecessary regulatory burden on the exchange market because exchange trading of such bonds is not susceptible to the types of market abuse that the short sale rule is designed to prevent. Moreover, given the limited amount of bond trading effected on exchanges, there would appear to be little reason for concern over the effect of short selling of bonds on an exchange. Accordingly, the Commission proposed to exclude transactions in bonds from Rule 10a-1 by amending paragraph (b) to add the phrase "except a bond or debenture."²⁰⁶ It was also determined that up until the time that final action was taken on this proposed amendment, no-action relief would be provided under Rule 10a-1 with regard to short sales in exchange-listed bonds.²⁰⁷

Commenters were generally in favor of this proposed amendment and some also recommended that convertible bonds be excluded from Rule 10a-1 as well.²⁰⁸ The amendments proposed in the 1992 release were never adopted or withdrawn. We believe that the same rationales that were cited in 1992 generally continue to apply today. In addition, as there is not currently a source for consolidated quote information on corporate bonds similar to what exists for equity securities, it is evident that our proposed bid test could not be applicable in the bond market.²⁰⁹ We have thus proposed that the uniform bid test in Regulation SHO would not apply to bonds.²¹⁰

Q. Should corporate bonds be excluded from proposed Rule 201?

XIV. After Hours Trading/Foreign Markets Issues

A. After-Hours Trading

Trading in U.S. stocks outside of regular market hours is not a new

²⁰⁶ Convertible bonds were not proposed to be excluded from the Rule. The Commission noted that convertible bonds are defined as "equity securities" in the Exchange Act (Section 3(a)(11), 15 U.S.C. 78c(a)(11)). Further, it was argued that short selling of convertible bonds (at least in the much larger OTC market) might have an impact on the price of related exchange-traded equity securities. *Id.* at n. 43.

²⁰⁷ *Id.*

²⁰⁸ See Letters from American Bar Association, Bear Stearns & Co., Inc., New York Stock Exchange, Securities Industry Association, and Sullivan & Cromwell.

²⁰⁹ In 2001, the Commission approved a proposal by the NASD to establish a corporate bond reporting and transaction dissemination facility, TRACE. See Securities Exchange Act Release No. 43873 (January 23, 2001), 66 FR 8131 (January 29, 2001) (SR-NASD-1999-65) (order approving TRACE).

²¹⁰ Should there in the future be a source for consolidated quote information on corporate bonds, we may decide to revisit the application of the bid test to bonds.