

(iv) Short sales used to calculate the VWAP will themselves be subject to the provisions of paragraph (b) this section, unless excepted or exempted, and § 240.203 of this chapter; and

(v) The VWAP matched security:

(A) Qualifies as an “actively-traded security”; or

(B) The proposed short sale transaction is being conducted as part of a basket transaction of twenty or more securities in which the subject security does not comprise more than five percent of the value of the basket traded;

(vi) The transaction is not effected for the purpose of creating actual, or apparent, active trading in or otherwise affecting the price of any security;

(vii) A broker or dealer shall be permitted to act as principal on the contra-side to fill customer short sale orders only if the broker or dealer's position in the covered security, as committed by the broker-dealer during the pre-opening period of a trading day and aggregated across all of its customers who propose to sell short the same security on a VWAP basis, does not exceed 10% of the covered security's relevant average daily trading volume;

(9) A sale of any covered security when the broker or dealer is effecting the execution of a customer “long” sale on a riskless principal basis, regardless of the broker or dealer's proprietary net position; and

(10) A sale of any covered security at a price equal to the consolidated best bid by a broker or dealer to satisfy any obligations of the broker or dealer to a customer limit order, as determined by federal securities laws or the rules of a self-regulatory organization.

(e) Upon written application or upon its own motion, the Commission may grant an exemption from the provisions of this section, either unconditionally or on specified terms and conditions, to any transaction or class of transactions, or to any security or class of securities, or to any person or class of persons.

#### **§ 242.202(T) Temporary short sale rule suspension.**

*General rule.* Short sales in specified securities constituting a subset of the Russell 1000 index, or such other securities as the Commission designates as permissible by order as necessary or appropriate in the public interest and consistent with the protection of investors after giving due consideration to the security's liquidity, volatility, market depth and trading market, may be effected without regard to the

provisions of paragraph (b) of § 242.201. All other provisions of § 242.201 shall remain in effect.

#### **§ 242.203 Borrowing and delivery requirements.**

(a) *Long sales.* (1) If a broker or dealer knows or has reasonable grounds to believe that the sale of a security was or will be effected pursuant to an order marked “long,” such broker or dealer shall not lend or arrange for the loan of any security for delivery to the broker for the purchaser after sale, or fail to deliver a security on the date delivery is due, unless the broker or dealer knows or has been informed by the seller that the seller owns the security and will deliver it to the clearing broker or dealer prior to the scheduled settlement of the transaction.

(2) The provisions of paragraph (a)(1) of this section shall not apply to:

(i) The loan of any security by a broker or dealer through the medium of a loan to another broker or dealer; or

(ii) Any loan of, arrangement for the loan of, or failure to deliver any security, if, prior to such loan, arrangement or failure to deliver, a national securities exchange, in the case of a sale effected thereon, or a national securities association, in the case of a sale not effected on an exchange, finds:

(A) That such sale resulted from a mistake made in good faith;

(B) That due diligence was used to ascertain that the circumstances specified in § 242.201(c) existed; and

(C) Either that the condition of the market at the time the mistake was discovered was such that undue hardship would result from covering the transaction by a “purchase for cash” or that the mistake was made by the seller's broker and the sale was at a price permissible for a short sale under § 242.201(b).

(b) *Short sales.*

(1) A broker or dealer may not execute a short sale order for its own account or the account of another person unless the broker or dealer, or the person for whose account the short sale is executed:

(i) Borrowed the security, or entered into a bona-fide arrangement to borrow the security; or

(ii) Had reasonable grounds to believe that it could borrow the security so that it would be capable of delivering the securities on the date delivery is due.

(2) The provisions of paragraph (b)(1) of this section shall not apply to short sales executed by specialists or market makers in connection with bona-fide market making activities. Bona-fide

market making activities shall not include activity that is related to speculative selling strategies or investment purposes of the broker or dealer or is disproportionate to the usual market making patterns or practices of the broker or dealer in that security.

(3) For any security where there are fails to deliver at a clearing agency registered with the Commission of 10,000 shares or more, and that is equal to at least one-half of one percent of the issue's total shares outstanding, if a broker or dealer executes a short sale for its own account or the account of another person, and if for any reason whatever securities have not been delivered within two days after the settlement date:

(i) For a period of ninety calendar days the broker or dealer shall not execute a short sale in such security for his own account or the account of the person for whose account the failure to deliver occurred unless the broker or dealer or the person for whose account the short sale is executed has borrowed the security, or entered into a bona fide arrangement to borrow the security, and will deliver the security on the date delivery is due; and

(ii) The rules of a clearing agency registered pursuant to Section 17A (15 U.S.C. 78q-1) of the Act shall include the following provisions:

(A) A broker or dealer failing to deliver securities as specified in subparagraph (3) above shall be referred to the NASD and the Examining Authority (as defined in 15c3-1(c)(12)) for such broker or dealer for appropriate action; and

(B) The registered clearing agency shall withhold a benefit equal to any mark to market amounts or payments that otherwise would be made to the participant failing to deliver, and assess appropriate charges.

(c) Upon written application or upon its own motion, the Commission may grant an exemption from the provisions of this section, either unconditionally or on specified terms and conditions, to any transaction or class of transactions, or to any security or class of securities, or to any person or class of persons.

Dated: October 28, 2003.

By the Commission.

**Margaret H. McFarland,**

*Deputy Secretary.*

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