

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 241

[Release No. 34-48795]

Commission Guidance on Rule 3b-3 and Married Put Transactions

AGENCY: Securities and Exchange Commission.

ACTION: Interpretation.

SUMMARY: The Securities and Exchange Commission is publishing interpretive guidance on calculating a “net long” position under the Securities Exchange Act of 1934 when using married put transactions as a part of certain trading strategies. A seller of securities is required to aggregate all of its positions in that security to determine the seller’s “net long” position. Determining security ownership is an essential component to aggregating security positions under the Securities Exchange Act of 1934. The guidance we are publishing today clarifies the determination of security ownership when married puts transactions are used.

EFFECTIVE DATE: November 21, 2003.

FOR FURTHER INFORMATION CONTACT: Any of the following attorneys in the Office of Trading Practices, Division of Market Regulation, Securities and Exchange Commission, 450 Fifth Street NW., Washington, DC 20549-1001, at (202) 942-0772: James Brigagliano, Assistant Director, or Gregory Dumark, Kevin Campion, and Elizabeth Sandoe, Special Counsels.

SUPPLEMENTARY INFORMATION:

I. Background

A seller of securities must determine whether a sale is “long” or “short” because of special provisions applying to short sales.¹ This determination depends in significant measure on whether the seller owns the security to be sold and the seller’s net position in the security. Rule 3b-3 under the Exchange Act provides, in part, that a person owns a security if he or his agent has title to a security or he has purchased or has entered into an

unconditional contract to purchase it but has not yet received it.²

The seller’s net position must be determined with reference to Rule 3b-3. Rule 3b-3 requires a seller of an equity security to aggregate all of its positions in that security.³ If the seller has a “net long” position in the security after this aggregation process, then the sale may be effected as a “long” sale to the extent of the “net long” position. If the aggregation process results in a “flat” or “net short” position, the sale must be effected as a “short” sale. All sell orders in any security registered on or admitted to unlisted trading privileges on a national securities exchange must be marked either “long” or “short.”⁴ A short sale of an exchange-listed security must comply with Rule 10a-1 under the Exchange Act.⁵ A sale of a “long” position is not subject to the price test of Rule 10a-1.

Calculation of a seller’s net position is also necessary for compliance with Rule 105 of Regulation M.⁶ Rule 105 prohibits covering a short sale with offering securities obtained from an underwriter or dealer if the short sale

² 17 CFR 240.3b-3(a)–(b). In addition, Rule 3b-3 provides that a person has a “long” position in a security if he holds convertible securities, options, rights, or warrants, and has tendered for conversion or exchange the convertible securities or exercised the options, rights, or warrants. 17 CFR 240.3b-3(c)–(e). Rule 3b-3 defines the term “short sale” as any sale of a security that the seller does not own or any sale that is consummated by the delivery of a security borrowed by, or for the account of, the seller.

³ See Exchange Act Release No. 20230 (September 27, 1983), 48 FR 45119, 45120 (October 3, 1983) (to determine whether a person has a “net long” position in a security, all accounts must be aggregated).

⁴ 17 CFR 240.10a-1(c).

⁵ 17 CFR 240.10a-1. Rule 10a-1 (commonly referred to as the “short sale rule” or “tick test”) prohibits, subject to certain narrow exceptions, short sales of any security registered on or admitted to unlisted trading privileges on a national securities exchange on minus or zero-minus ticks. Generally, the short sale rule is designed to prevent short selling from accelerating a declining market. Aggregation under Rule 3b-3 is also necessary to ensure compliance with the short sale “bid test” of NASD Rule 3350. See Rule 3350(k)(1) and NASD Notice to Members 94-68, Question 15.

⁶ 17 CFR 242.105. Rule 105 prevents persons from covering short sales with offering securities purchased from an underwriter, broker, or dealer participating in the offering if the short sale was effected during the Rule’s restricted period, which is typically five days prior to pricing and ending with pricing (“105 restricted period.”) Rule 105 is designed to ensure that “secondary” and “repeat” offering prices are based on open market prices determined by supply and demand rather than influenced by artificial forces, and to prevent artificial depression of trading markets that may reduce an issuer’s offering proceeds. See *Short Sales in Connection with a Public Offering*, Exchange Act Release No. 26028 (August 25, 1988), 53 FR 33455 (August 31, 1988) (release adopting the predecessor to Rule 105, Rule 10b-21, which prohibited substantially the same conduct as Rule 105).

occurred during the period 5 days prior to pricing until pricing or the period from filing the registration until pricing, whichever is shorter.⁷ Thus, a seller needs to know if any sales during the 5-day period prior to certain repeat or secondary offerings are short sales for which offering shares may not be used to cover such sales.

This release discusses the operation of Rule 3b-3 with respect to sellers who may claim to have a position in a security by virtue of having entered into a “married put” transaction.⁸

II. Discussion

A married put is the purchase of an option to sell (*i.e.*, a put option) a certain number of securities at a particular price by a specified time, bought contemporaneously with the same number of underlying securities.⁹ When used as a hedging vehicle, the married put is designed to provide protection to the holder of the stock against losses, *i.e.*, if the price of the stock goes up, the put will not be exercised and will expire worthless, and if the price of the stock goes down, the put may be exercised by the holder to sell the underlying stock at the strike price.

The Securities and Exchange Commission (the “Commission”) is concerned about the abusive use of married puts as a part of trading strategies designed to evade the application of Rule 10a-1 and Rule 105.¹⁰ Some of these strategies appear to

⁷ 17 CFR 242.105(a)(1) and (a)(2). Rule 105 does not apply to offerings filed under Rule 415 of the Securities Act of 1933 (*i.e.*, “shelf offerings”) or to offerings that are not conducted on a firm commitment basis. 17 CFR 242.105(b).

⁸ The Commission has proposed new Regulation SHO that, among other things, would apply a new uniform bid test to all exchange-listed securities and Nasdaq National Market System (“NMS Security”) securities, wherever traded, allowing short sales to be effected at a price one cent above the consolidated best bid. The interpretive guidance we are issuing today on calculating a “net long” position applies regardless of whether the Commission adopts Regulation SHO.

⁹ The term “married put” is used to describe the underlying transaction, *i.e.*, the linked purchase of securities and the put option to sell an equivalent number of securities. Several different terms have been used in the industry to describe various strategies involving married put transactions including, but not limited to, “bullets,” “ghost bullets,” “bullet trades,” and “slam dunks.” All of these strategies involve the use of married put transactions.

¹⁰ Traders may also be using married put transactions as part of a scheme to avoid the short sale “bid test” adopted by the NASD, Rule 3350. Although an NASD rule, a trader must calculate his “net long” position pursuant to Commission Rule 3b-3 in order to comply with Rule 3350. See, *supra* n. 5. Rule 3350 provides that with respect to trades executed on or reported to Nasdaq no member shall effect a short sale, for the account of a customer or for its own account, in a Nasdaq NMS security at

¹ This interpretation discusses the operation of Rule 10a-1 under the Securities Exchange Act of 1934 (“Exchange Act”), 17 CFR 240.10a-1, and Rule 105 of Regulation M, 17 CFR 242.105. It does not address the operation of all provisions that apply to short sales, such as general anti-fraud and anti-manipulation provisions, *e.g.*, Sections 17(a)(1) and 10b-5 of the Exchange Act, and self-regulatory organization rules, *e.g.*, National Association of Securities Dealers, Inc. (“NASD”) Rule 3370, New York Stock Exchange (“NYSE”) Rule 440C.