

National Policy Bulletin



National Association of Real Estate Investment Trusts®

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SEC Seeks Public Comment on Proposals Related to Short Sales Restrictions, Including Reinstatement of “Uptick” Rule

Executive Summary

Today, the Securities and Exchange Commission (SEC) voted unanimously to seek public comment on five proposals to restrict short sales under certain circumstances, including the potential reinstatement of the “uptick” rule, which was repealed by the SEC in 2007. The public comment period will last for 60 days once a formal request is printed in the *Federal Register* in the coming days. The SEC took this action after receiving considerable interest on this issue from investors, representatives of public companies such as NAREIT, brokerage firms and exchanges, and Members of Congress, who have been publicly encouraging the SEC to reinstate the “uptick” rule as a way to address the extreme conditions in the economy and restore confidence and integrity in the market. Newly-appointed SEC Chairman Mary Schapiro indicated the SEC would undertake a “thoughtful, deliberative process to determine what is in the best interests of investors.”

Short Sales Proposals

The specific details of each of the proposals have yet to be made public. However, the Commission intends to address potential restrictions on short selling with two approaches: a market-wide approach on a permanent basis and a security-specific approach that would be temporary during severe market declines in that security.

Market-Wide, Permanent Approach

This approach would include two proposals that are both related to the former “uptick” rule. First, a reinstatement of the “uptick” rule, that was first implemented in 1938 and repealed by the SEC in 2007, or a market-wide short sale price test based on the last sale price, or tick, of a stock.



The second proposal would be a modified “uptick” rule, or a market-wide short sale price test based on the national best bid of a stock. These proposals would be implemented on a permanent basis and be instituted market-wide.

Security-Specific, Temporary Approach

This approach would implement a “circuit breaker” on short sales of specific securities during a trading session if the price of that security declines by 10 percent. Under the proposal, once the “circuit breaker” is triggered on a specific security, short sales would either: 1) be banned or halted for the remainder of the trading session; 2) have a price test imposed that is based on the national best bid for the rest of the trading session, or a temporary modified “uptick” rule; or, 3) experience a price test based on the last sales price for the remainder of the trading session, or a temporary “uptick” rule. These proposals would be implemented on a temporary basis and only pertain to specific securities.

Background

As indicated, the “uptick” rule was first implemented in 1938 during the Great Depression as way of preventing traders from short selling a stock unless the price of that stock from the most recent trade was higher than the previous price. After conducting a pilot study in 2004 on the effects that eliminating the short sale price restrictions would have on certain securities, the SEC eliminated the “uptick” rule in 2007. The severe volatility witnessed in the stock market in 2008 forced the SEC to issue an emergency order in July imposing borrowing and delivery requirements on short sales of the equity securities of certain financial institutions, including some REIT stocks. In September of last year, the SEC issued another emergency order temporarily prohibiting short selling in the publicly-traded securities of certain financial institutions, including some REIT stocks.

Congressional Reaction

As SEC Chairman Schapiro indicated, many Members of Congress have voiced concern to the SEC in recent weeks and expressed their strong support for reinstatement of the “uptick” rule to bring more stability to the financial markets. In recent hearings before the House Financial Services Committee and the Senate Banking Committee, both committee chairmen, Rep. Barney Frank (D-MA) and Sen. Christopher Dodd (D-CT), encouraged the SEC to move quickly to restore the “uptick” rule. In addition, 27 members of the House Financial Services Committee, including Chairman Frank and Ranking Republican Member Rep. Spencer Bachus (R-AL), signed a March 11 letter to Ms. Schapiro urging her to reinstate the “uptick” rule to restore “investor faith in the fundamental integrity of the market.”

Sen. Edward Kaufman (D-DE) and Sen. Johnny Isakson (R-GA) introduced bipartisan legislation,

S. 605, on March 16 requiring the SEC to reinstate the “uptick” rule and promulgate regulations to address abusive short selling activities. They also sent a letter to Chairman Schapiro on April 1 that was signed by four of their colleagues - Sens. Levin (D-MI), Tester (D-MT), Chambliss (R-GA) and Specter (R-PA) – on the eve of today’s SEC hearing to encourage the SEC to take proper action to address abusive short selling practices.

NAREIT has continued to voice its strong recommendation that Congress encourage the SEC to bring back the “uptick” rule in response to last fall’s volatility in the stock market that clearly was exacerbated by the lack of the “uptick” rule. NAREIT may provide comment to the SEC on the proposed short selling recommendations released for public comment. Please contact Emily Reid at ereid@nareit.com if you are interested in participating on a task force that would consider filing such comments.

For further information, please contact Tony Edwards at tedwards@nareit.com, Robert Dibblee at rdibblee@nareit.com.

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