

SECURITIES AND EXCHANGE COMMISSION

17 CFR PART 242

[Release No. 34-58107; File No. S7-19-07]

RIN 3235-AJ57

Amendment to Regulation SHO

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule; notice of re-opening of comment period.

SUMMARY: The Securities and Exchange Commission is re-opening the comment period on the “Amendments to Regulation SHO” it re-proposed in Securities Exchange Act Release No. 56213 (August 7, 2007), 72 FR 45558 (August 14, 2007), (the “Proposal”). In view of the continuing public interest in the Proposal we believe that it is appropriate to re-open the comment period to provide the public with additional information before we take action on the Proposal.

DATES: Comments should be received on or before August 13, 2008.

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission’s Internet comment form (<http://www.sec.gov/rules/proposed.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-19-07 on the subject line; or
- Use the Federal eRulemaking Portal (<http://www.regulations.gov>). Follow the instructions for submitting comments.

Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090. All submissions should refer to File Number S7-19-07. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/proposed.shtml>). Comments are also available for public inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT: James A. Brigagliano, Associate Director, Josephine J. Tao, Assistant Director, Victoria L. Crane, Branch Chief and Christina M. Adams, Staff Attorney, Office of Trading Practices and Processing, Division of Market Regulation, at (202) 551-5720, at the Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

SUPPLEMENTARY INFORMATION: The Commission is requesting additional public comment on proposed amendments to Rules 200 and 203 of Regulation SHO [17 CFR 242.200 and 242.203] under the Securities Exchange Act of 1934 ("Exchange Act"). In the Proposal, the Commission re-proposed amendments to Regulation SHO under the Exchange Act intended to further reduce the number of persistent fails to

deliver¹ in certain equity securities by eliminating the options market maker exception to the close-out requirement of Regulation SHO. The Commission also sought comment on two alternatives to elimination that would limit the scope of the options market maker exception. The Commission is re-opening the comment period, which ended on September 13, 2007, to provide additional information with respect to the Proposal to the public.

At the same time that the Commission re-proposed amendments to Regulation SHO to eliminate the options market maker exception to Regulation SHO's close-out requirement, the Commission approved amendments to Regulation SHO to eliminate the rule's "grandfather" provision.² The "grandfather" provision had provided that fails to deliver established prior to a security becoming a threshold security did not have to be closed out in accordance with Regulation SHO's thirteen consecutive settlement day close-out requirement. The amendment to eliminate the "grandfather" exception became effective on October 15, 2007. The amendment also contained a one-time phase-in period that provided that previously-grandfathered fails to deliver in a security that was a threshold security on the effective date of the amendment must be closed out within 35 consecutive settlement days from the effective date of the amendment. The phase-in period ended on December 5, 2007.³

¹ A "fail to deliver" occurs when the seller of a security fails to deliver the security by settlement date. Generally, investors must complete or settle their security transactions within three business days. This settlement cycle is known as T+3 (or "trade date plus three days"). T+3 means that when the investor purchases a security, the purchaser's payment generally must be received by its brokerage firm no later than three business days after the trade is executed. When the investor sells a security, the seller generally must deliver its securities, in certificated or electronic form, to its brokerage firm no later than three business days after the sale.

² Securities Exchange Act Release No. 56212 (Aug. 7, 2007), 72 FR 45544 (Aug. 14, 2007).

³ See id.

In response to the Proposal, commenters urged the Commission to obtain empirical data to demonstrate the relationship between fails to deliver and the options market maker exception before it determines whether additional rulemaking is necessary. In particular, commenters urged the Commission to obtain data relating to the impact of the elimination of the grandfather provision and connecting fails to deliver to the options market maker exception.⁴ The Commission has obtained additional data on fails to deliver since the Proposal was published. Accordingly, in response to commenters and because the Commission believes the additional data will aid the public in commenting on the Proposal, the Commission is re-opening the comment period to share with the public data obtained by the Commission regarding fails to deliver and the options market maker exception, and to provide the public with an opportunity to comment on the data.

To ascertain whether fails to deliver are not being closed out due to the options market maker exception to the close-out requirement since the elimination of the “grandfather” provision, Commission staff obtained data on securities with extended fails to deliver from a National Securities Clearing Corporation (“NSCC”) participant which settles and clears for a large segment of the options market for January and February 2008. A review of this data reveals that a high number of fails to deliver were not closed out as a result of the options market maker exception.⁵ Specifically, the data indicated that as of January 31, 2008, the options market maker exception was claimed in 16 threshold securities for a total of 6,365,158 fails to deliver. As of February 29, 2008, the

⁴ See e.g., Comments of Keith F. Higgins, Committee on Federal Regulation of Securities, American Bar Association, Section of Business Law (Oct. 5, 2007); comments of John Gilmartin and Ben Londergan, Group One Trading, LP (Sept. 28, 2007); see also comments of Gerald D. O’Connell, Susquehanna Investment Group (Oct. 11, 2007).

⁵ We note that the data reflects only those extended fails to deliver not closed out due to the options market maker exception and, therefore, does not reflect all fails to deliver in the securities included in the data.

data indicated that the options market maker exception was claimed in 20 threshold securities for a total of 6,963,949 fails to deliver.

In addition, the Commission is releasing the results of a recent analysis by the Commissions' Office of Economic Analysis ("OEA") of fails to deliver before and after the elimination of Regulation SHO's "grandfather" provision.⁶ As set forth below, these results show that extended fails to deliver in non-optionable threshold securities declined significantly after the elimination of the "grandfather" provision while extended fails to deliver in optionable threshold securities increased significantly. Specifically, changes for optionable threshold securities include:

- The average daily number of optionable threshold list securities increased by 25.0%.
- The average daily number of new fail to deliver positions in optionable threshold securities increased by 45.3%.
- For fails aged more than 17 days in optionable threshold securities, the average daily dollar value of fails to deliver increased by 73.4%.
- For fails aged more than 17 days in optionable threshold securities, the average daily number of fail to deliver positions increased by 30.7%.
- The average daily number of optionable threshold list securities with fails aged more than 17 days increased by 40.9%.

Further, changes for non-optionable threshold securities include:

- The average daily number of non-optionable threshold list securities decreased by 3.5%.
- The average daily number of new fail to deliver positions in non-optionable threshold securities increased by 7.4%.
- For fails aged more than 17 days in non-optionable threshold securities, the average daily dollar value of fails to deliver decreased by 34.5%.
- For fails aged more than 17 days in non-optionable threshold securities, the average daily number of fail to deliver positions decreased by 38.8%.

⁶ See Memorandum from the Commission's Office of Economic Analysis (dated June 9, 2008), which is available on the Commission's internet website at <http://www.sec.gov/comments/s7-19-07/s71907.shtml> (the "OEA Memorandum"). As discussed above, the "grandfather" provision was eliminated as of October 15, 2007 with a one-time phase in period which expired on December 5, 2007. The sample data used in the OEA Memorandum compares two time periods: April 9, 2007 – October 14, 2007, which is defined as the "pre-amendment period" and December 10, 2007 – March 31, 2008, which is defined as the "post-amendment period."

- The average daily number of non-optionable threshold list securities with fails aged more than 17 days decreased by 32.6%.⁷

To ascertain the extent to which fails to deliver were not being closed out due to the options market maker exception to the close-out requirement prior to the elimination of the “grandfather” provision, Commission staff obtained data from certain self-regulatory organizations for 2006 and 2007 regarding use of the options market maker exception. This data is explained in more detail below.

In 2007, as part of its regular Regulation SHO surveillance, the Financial Industry Regulatory Authority (“FINRA”) conducted a review of securities with extended fails to deliver at the NSCC to ascertain the continuing cause of fails to deliver, and to also assess compliance with NYSE Rule 440/SEA⁸ and Regulation SHO. As set forth below, according to data provided by one NSCC participant that settles and clears for a large segment of the options market, a number of fails to deliver at that participant were not closed out due to claims that the fails were excepted from the close-out requirement as a result of the options market maker exception.

A review of the FINRA data for 2007 shows the following:

Month	Fails to Deliver ⁹	No. of Securities
February	35,665	1
March	900,276	5
April	3,433,639	8
May	228,878	2
June	2,441,122	14
July	462,414	6
August	3,065,710	12

⁷ See *id.*

⁸ NYSE Rule 440 requires that “[e]very member not associated with a member organization and every member organization shall make and preserve books and records as the Exchange may prescribe and as prescribed by Rule 17a-3.”

⁹ These numbers represent fails to deliver which, as explained in footnote 1 above, are shares of a security that are not delivered by settlement date. According to the data provided to FINRA, these fails to deliver were not closed out due to the options market maker exception.

October	4,456,340	13
November	1,841,063	2
December	5,621,982	15

As indicated in the table above, the options market maker exception to the close-out requirement was claimed for a large number of fails to deliver for the entire year, including both before and after October 15, 2007, the effective date of the elimination of Regulation SHO’s “grandfather” provision.

On December 11, 2006 the Chicago Board of Options Exchange (“CBOE”) along with the American Stock Exchange, NYSE Arca, Inc., and the Philadelphia Stock Exchange initiated a Regulation SHO review of options market makers covering the time period from May through July 2006. The focus of these reviews was the options market maker exception to the close-out requirement for aged fails to deliver in threshold securities that were open for thirteen consecutive settlement days.¹⁰

According to CBOE, the reviews revealed that there were 598 exceptions claimed, covering 58 threshold securities for a total of 11,759,799 fails to deliver. For the 58 threshold securities identified, the number of fails to deliver for which an exemption was claimed from the close-out requirement ranged from 207 to 1,950,655.

The following is a distribution of the number of fails to deliver:

<u># of Fails to Deliver for which Exception Was Claimed</u>	<u># of Threshold Securities</u>
0 - 100,000	35
100,001 - 200,000	4
200,001 - 300,000	4
300,001 - 400,000	5
400,001 - 500,000	4
500,001 - 600,000	2

¹⁰ The “grandfather” provision was also in effect during this period but was not the subject of these reviews.

600,001 - 700,000	-
700,001 - 800,000	1
800,001 - 900,000	-
900,001 - 1,000,000	1
> 1,000,000	2

Therefore, the Commission is re-opening the comment period for Exchange Act Release No. 56213 from the date of this release through August 13, 2008.

By the Commission.

Florence E. Harmon
Acting Secretary

Dated: July 7, 2008