

Alerts & Publications

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U.S. and Non-U.S. Fund Advisers Targeted in SEC Short Selling Cases

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On Tuesday, the Securities and Exchange Commission (“SEC”) announced a major enforcement crackdown against 23 U.S. and international entities for short selling in connection with a public equity offering in violation of Rule 105 of Regulation M under the Securities Exchange Act of 1934.[1] The SEC’s National Exam Program simultaneously issued a risk alert highlighting the need for firms to focus on their internal controls for compliance with Rule 105,[2] available [here](#).

The 23 enforcement actions targeted domestic and international investment advisers, including private-fund advisers; U.S. and international proprietary trading firms; and registered broker-dealers.[3] In each of the cases, the firm sold short during the Rule 105 restricted period shares of securities that were the subject of a public equity offering. The firm subsequently profited by purchasing shares of the security in the equity offering at a price lower than the amount received in the short sale.

Rule 105 makes it unlawful for any person to sell short a security that is the subject of a public equity offering during the Rule 105 restricted period and then purchase the offered securities from an underwriter, prospective underwriter, or broker-dealer participating in the offering. The “Rule 105 restricted period” is typically five days.[4] The Rule does not require scienter, so its provisions apply regardless of the short seller’s intent. A person who during the restricted period sells short a security that is the subject of an offering must refrain from purchasing shares of that security in the offering, subject to certain limited exceptions.

The broad sweep of the SEC's initiative reinforces its continued emphasis on enforcing U.S. securities laws against domestic and international advisers and funds. The SEC's focus on Rule 105 short sale practices across the industry represents a significant signal to all firms participating in public equity offerings. Firms should keep in mind that after-the-fact remediation does not absolve them from violations of Rule 105, and firms should implement robust and proactive short sale procedures to detect and prevent Rule 105 violations. The SEC's Risk Alert explicitly warned of the risks facing firms whose policies and procedures fail to identify, mitigate, and manage the risks associated with short selling in connection with public equity offerings. To minimize enforcement risk, firms should:

- reassess their policies and procedures;
- reinforce compliance by their employees through training; and
- enhance compliance monitoring and testing mechanisms.

O'Melveny & Myers is available to advise domestic and non-U.S. investment advisers and fund managers about U.S. securities compliance. For questions, please contact Heather Traeger at (202) 383-5232, Kris Easter at (202) 383-5364, or Jim Harrigan at (202) 383-5226.

[1] 22 of the 23 enforcement actions have settled to date, for a combined \$14.4 million in monetary sanctions of disgorgement, prejudgment interest, and penalties. The penalties ranged from \$65,000 to \$679,950. For information about the individual enforcement actions, click [here](#).

[2] National Exam Program Risk Alert: Rule 105 of Regulation M: Short Selling in Connection With a Public Offering (September 17, 2013) available at: <http://www.sec.gov/about/offices/ocie/risk-alert-091713-rule105-regm.pdf>.

[3] 17 of the 23 enforcement actions were filed against investment advisers, including U.S. and non-U.S. advisers and exempt reporting advisers.

[4] Specifically, the restricted period is the shorter of either (1) a period commencing five business days before the pricing of the offered securities and ending with such pricing, or (2) a period commencing with the initial filing of the registration statement or notification on Form 1-A or Form 1-E and ending with the pricing.

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