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For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>16</sup>

**Jill M. Peterson,**  
Assistant Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-89659; File No. TP 20-02]

### Order Granting Exemptions From Certain Rules Related to the Sale and Delivery of Physical Securities Under Regulation SHO Related to COVID-19

August 25, 2020.

#### I. Introduction

The Depository Trust & Clearing Corporation ("DTCC") has intermittently suspended physical securities processing services provided by the Depository Trust Company ("DTC"), its subsidiary, due to ongoing concerns related to the effects of COVID-19.<sup>1</sup> While DTCC has resumed limited services for new physical securities transactions,<sup>2</sup> there are likely

to be delays in settlement for the sales of equity securities that the seller is "deemed to own" pursuant to Rule 200(b) of Regulation SHO,<sup>3</sup> and for which settlement is dependent on the delivery of physical certificates ("owned physical securities"), which may result in extended failures to deliver<sup>4</sup> and have resulting implications for compliance with Regulation SHO under the Securities Exchange Act of 1934 (the "Exchange Act").<sup>5</sup> The Securities Industry and Financial Markets Association ("SIFMA") has requested on behalf of its member firms exemptive relief from certain provisions of Regulation SHO<sup>6</sup> in connection with the intermittent suspension of physical securities processing at DTC due to ongoing concerns related to COVID-19.<sup>7</sup>

The Commission is providing certain exemptive relief from the "locate" and

V5TVRSailsInQioiJPSzFvVE1qM0ZWTWdXR1ZzZIB3c1pNYWJmOWZUUh1Qyt0b29sYmV4cnlwWWWXYXdWTjQrSXNaOHpyYwQ1RINIwVfQeGhoYTN3cDJaRFwvb1JPRGdzR2c9PSJ9. DTC has requested that participants only submit urgent time-sensitive transactions. "Partial Resumption of DTC Physical Securities Processing," Important Notice B# 13402-20 (May 14, 2020) available at <https://www.dtcc.com/-/media/Files/pdf/2020/5/14/13402-20.pdf>.

<sup>3</sup> 17 CFR 242.200(b).

<sup>4</sup> Specifically, failures to deliver securities may occur at the Continuous Net Settlement system, or "CNS," which is operated by the National Securities Clearing Corporation ("NSCC"), a subsidiary of DTCC. Rule 204 of Regulation SHO applies specifically to failures to deliver in equity securities occurring at CNS. 17 CFR 242.204.

<sup>5</sup> 17 CFR 242.200 *et seq.*

<sup>6</sup> Letter from Robert Toomey, Managing Director & Associate General Counsel, SIFMA, dated May 21, 2020. SIFMA stated in its request that the Commission granted similar exemptive relief in 2012 in the aftermath of Hurricane Sandy. See Order Granting Exemptions From Certain Rules of Regulation SHO Related to Hurricane Sandy, Release No. 34-68419 (Dec. 12, 2012) (the "2012 Hurricane Sandy Order"), available at <https://www.sec.gov/rules/exorders/2012/34-68419.pdf>. The 2012 Hurricane Sandy Order granted exemptions from certain provisions of Regulation SHO related to the inaccessibility of physical certificates that resulted from water damage incurred at DTCC's vault used as part of its Custody Service for safekeeping of physical certificates.

<sup>7</sup> DTCC suspended but recently resumed processing of physical securities. "Partial Resumption of DTC Physical Securities Processing," Important Notice B# 13402-20 (May 14, 2020) available at <https://www.dtcc.com/-/media/Files/pdf/2020/5/14/13402-20.pdf>. However, based on conversations with SIFMA, we understand that regular processing may be intermittent during the current crisis, and that there may be delays in processing certain physical securities after DTCC resumes processing after a suspension. See, e.g., letter from Robert Toomey, *supra* note 6 ("While DTCC has resumed limited services in connection with processing physical securities . . . we believe the requested relief continues to be appropriate and should also provide, given the ongoing uncertainties in connection with the COVID-19 crisis, mechanisms that would allow market participants to rely on the relief should there be further intermittent suspensions of physical securities processing during this crisis period.").

close-out requirements of Regulation SHO, as described in more detail below, for sales of owned physical securities.

#### II. Regulation SHO

##### A. Rule 200 Marking Requirement and Rule 203 "Locate" Requirement

Rule 200(g) of Regulation SHO<sup>8</sup> provides that broker-dealers must mark all sell orders of any equity security as "long," "short," or "short exempt." Under Rule 200(g)(1), a broker-dealer may mark an order to sell "long" only if the seller is "deemed to own" the security being sold pursuant to paragraphs (a) through (f) of Rule 200 and either: (1) the security to be delivered is in the physical possession or control of the broker-dealer; or (2) it is reasonably expected that the security will be in the physical possession or control of the broker-dealer no later than the settlement of the transaction.

Due to the intermittent inaccessibility of physical certificates at DTC as a result of ongoing concerns related to the effects of COVID-19, sell orders for owned physical securities may not qualify for "long" order marking under Rule 200(g)(1).<sup>9</sup> Specifically, a broker-dealer may not have a reasonable expectation that such securities will be in the physical possession or control of the broker-dealer by the settlement date.<sup>10</sup> Therefore, the broker-dealer would be required to mark such sale orders as "short" or, if eligible for Rule 201(c) or (d), "short exempt."<sup>11</sup>

Pursuant to Rule 203(b) of Regulation SHO, a broker-dealer may not accept a short sale order in an equity security from another person, or effect a short sale in an equity security for its own account, unless the broker-dealer has: (1) Borrowed the security, or entered into a *bona fide* arrangement to borrow the security; or (2) reasonable grounds to believe that the security can be borrowed so that it can be delivered on the date delivery is due.<sup>12</sup> This requirement is known as the "locate" requirement, and must be met and

<sup>8</sup> 17 CFR 242.200(g).

<sup>9</sup> See Exchange Act Release No. 50103 (July 28, 2004), 69 FR 48008, 48012, 48015 (Aug. 6, 2004) ("Regulation SHO Adopting Release"). As noted below, sales marked "short" and "short exempt" are generally subject to the Rule 203(b) locate requirement absent an exception.

<sup>10</sup> 17 CFR 242.200(g)(1)(ii).

<sup>11</sup> Certain sales of owned physical securities may also qualify under Rule 201(d)(1) to be marked "short exempt" provided that the broker-dealer executing the transaction makes the required determination regarding the seller's ownership of the security, and that the seller intends to deliver the security as soon as the current restrictions on delivery have been removed. 17 CFR 242.201(d)(1).

<sup>12</sup> 17 CFR 242.203(b).

<sup>16</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> E.g., "Temporary Suspension of DTC Physical Securities Processing as of Close of

Business on April 8, 2020," Important Notice B# 13276-20 (Apr. 8, 2020) available at <https://www.dtcc.com/-/media/Files/pdf/2020/4/8/13276-20.pdf>; "Update on Temporary Suspension of DTC Physical Securities Processing," Important Notice B#13352-20 (Apr. 30, 2020) available at <https://www.dtcc.com/-/media/Files/pdf/2020/4/30/13353-20.pdf>.

<sup>2</sup> "Coronavirus Client FAQ," DTCC (Aug. 4, 2020) available at [https://www.dtcc.com/-/media/Files/PDFs/Email-Files/Client-FAQ-Coronavirus.pdf?mkt\\_tok=eyJjoiTURFellqVXhPR0](https://www.dtcc.com/-/media/Files/PDFs/Email-Files/Client-FAQ-Coronavirus.pdf?mkt_tok=eyJjoiTURFellqVXhPR0)

documented prior to effecting a short sale.<sup>13</sup>

The Commission provided a specific exception to the “locate” requirement, however, for sales of such securities that the person is “deemed to own” pursuant to Rule 200(b) of Regulation SHO. Pursuant to Rule 203(b)(2)(ii), sales of such “deemed to own” securities are excepted from the “locate” requirement provided that the seller intends to deliver the securities as soon as all restrictions on delivery have been removed, and further provided that if the seller has not delivered such securities within 35 days after the trade date, the broker-dealer that effected the sale must borrow securities or close out the short position by purchasing securities of like kind and quantity.<sup>14</sup> In adopting this exception, the Commission emphasized that these sales are treated as short sales solely because the seller is unable to deliver the security that it owns to its broker-dealer prior to settlement, based on circumstances outside the seller’s control and through no fault of the seller or the broker-dealer.<sup>15</sup>

SIFMA has stated in conversations with Commission staff that fail to deliver positions resulting directly from DTC’s intermittent suspension of physical securities processing may persist for longer than the 35 day delivery requirement provided for under the Rule 203(b)(2)(ii) exception to the locate requirement for sales of securities that the seller is “deemed to own.” Therefore, absent the requested exemptive relief, SIFMA stated that broker-dealers effecting short sales for such owned physical securities would be required to either comply with the Rule 203(b) locate requirement, or alternatively, comply with the delivery requirement under Rule 203(b)(2)(ii) (*i.e.*, if the seller has not delivered such security within 35 days after the trade date, the broker-dealer that effected the sale must borrow securities or close out the short position by purchasing securities of like kind and quantity). We believe that requiring compliance with the Rule 203(b) “locate” requirement or the delivery requirement under Rule 203(b)(2)(ii) in spite of the anticipated delivery delays as a result of DTC’s intermittent suspension of physical securities processing due to ongoing concerns related to COVID-19 may

cause undue burdens on various market participants, particularly in the context of physical securities for which lending markets are small or non-existent. As a result, we believe that the temporary relief from the Rule 203(b) “locate” requirement of Regulation SHO for owned physical securities provided by this Exemptive Order is appropriate in the public interest and consistent with the protection of investors.

Accordingly, *it is ordered*, pursuant to Section 36 of the Exchange Act,<sup>16</sup> that a broker-dealer is exempt from the “locate” requirement of Rule 203(b), including the delivery requirement of Rule 203(b)(2)(ii), with respect to a short sale order in an owned physical security, subject to the following conditions:<sup>17</sup>

(a) The broker-dealer determines, prior to accepting such short sale order from another person, or effecting such short sale for its own account, that the sale is a sale of an owned physical security that the seller is “deemed to own” pursuant to Rule 200 of Regulation SHO;<sup>18</sup>

(b) The broker-dealer maintains contemporaneous records reflecting any reliance on this Order, and makes this information available to Commission staff upon request; and

(c) The broker-dealer provides notice on its website promptly upon its initial reliance on the Order and maintains the notice on its website until it ceases reliance on the Order.

#### *B. Close-Out Requirements Under Rule 204 of Regulation SHO*

Rule 204(a) of Regulation SHO<sup>19</sup> generally requires that participants of a registered clearing agency (“Participants”) close out fail to deliver positions at a registered clearing agency<sup>20</sup> in any equity security for a

sale transaction in that equity security by no later than the beginning of regular trading hours on the next settlement day after a fail to deliver resulting from a short sale (generally T+3), and no later than the beginning of regular trading hours on the third settlement day after a fail to deliver resulting from a long sale or a sale resulting from *bona fide* market making activities at the time of the sale (generally T+5). A close-out of a fail to deliver position is effected by purchasing or borrowing shares of like kind and quantity.

Similar to the exception to the “locate” requirement discussed above, Rule 204(a)(2) provides an extended close-out timeframe (T+35) for fail to deliver positions resulting from a sale of a security that a person is “deemed to own” and intends to deliver as soon as all restrictions on delivery have been removed.<sup>21</sup> Thus, fail to deliver positions resulting from sales of owned physical securities would ordinarily be eligible for the extended close-out timeframe provided by Rule 204(a)(2).<sup>22</sup> As noted above, however, SIFMA has stated in discussions with the Commission staff that, due to the inaccessibility of the physical certificates resulting from DTC’s intermittent suspension of physical securities processing, there may be instances in which sales of owned

the Exchange Act, that is registered as such pursuant to Section 17A of the Exchange Act. See 15 U.S.C. 78c(a)(23)(A); 15 U.S.C. 78q-1. The majority of equity trades in the United States are cleared and settled through systems administered by clearing agencies registered with the Commission. NSCC clears and settles the majority of equity securities trades conducted on the exchanges and in the over-the-counter market. NSCC clears and settles trades through CNS, which nets the securities delivery and payment obligations of all of its members. See Exchange Act Release No. 60388 (July 27, 2009), 74 FR 38266, 38268 n.35 (July 31, 2009) (“Rule 204 Adopting Release”).

<sup>21</sup> See 17 CFR 242.204(a)(2); see also Rule 204 Adopting Release, 74 FR at 38277 n.141. Under Rule 204(a)(2), a Participant that has a fail to deliver position resulting from a sale of a security that a person is “deemed to own” pursuant to Rule 200 of Regulation SHO and that such person intends to deliver as soon as all restrictions on delivery have been removed must, by no later than the beginning of regular trading hours on the thirty-fifth consecutive calendar day following the trade date for the transaction, immediately close out the fail to deliver position by purchasing or borrowing securities of like kind and quantity.

<sup>22</sup> See Rule 204 Adopting Release, 74 FR at 38277–38278. In providing an extended close-out timeframe for sales of “deemed to own” securities, the Commission stated that additional time is warranted for these sales and such additional time would not undermine the goal of reducing fail to deliver positions because “these are sales of owned securities that cannot be delivered by settlement date due solely to processing delays outside the seller’s or broker-dealer’s control,” and that “[m]oreover, delivery will be made on such sales as soon as all restrictions on delivery have been removed.” *Id.*

<sup>13</sup> Certain exceptions to the “locate” requirement are provided under Rule 203(b)(2). See 17 CFR 242.203(b)(2).

<sup>14</sup> See 17 CFR 242.203(b)(2)(ii); see also Regulation SHO Adopting Release, 69 FR at 48015.

<sup>15</sup> See Regulation SHO Adopting Release, 69 FR at 48015; see also Exchange Act Release No. 61595 (Feb. 26, 2010), 75 FR 11232, 11266 (Mar. 10, 2010).

<sup>16</sup> Section 36 of the Exchange Act authorizes the Commission, by rule, regulation or order, to exempt, either conditionally or unconditionally, any person, security or transaction, or any class or classes of persons, securities or transactions, from any provision or provisions of the Exchange Act or any rule or regulation thereunder, to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors. 15 U.S.C. 78mm(a).

<sup>17</sup> These conditions are designed to (1) ensure that executing brokers do not rely on the relief from Rule 203(b) granted in this Order beyond the extent to which the seller is “deemed to own” the relevant security, and (2) aid in ensuring participants’ compliance with this Order (to the extent they choose to avail themselves of the relief). The relief granted in this Order applies only in the context of suspensions of physical securities processing resulting directly from ongoing concerns related to COVID-19.

<sup>18</sup> 17 CFR 242.200.

<sup>19</sup> 17 CFR 242.204(a).

<sup>20</sup> The term “registered clearing agency” means a clearing agency, as defined in Section 3(a)(23)(A) of

physical securities may result in a CNS fail to deliver position that persists beyond the T+35 close-out timeframe.

Pursuant to Rule 204(b) of Regulation SHO,<sup>23</sup> if a Participant has not closed out a fail to deliver position in an equity security in accordance with Rule 204(a), the Participant and any broker-dealer from which the Participant receives trades for clearance and settlement, may not accept a short sale order in that equity security from another person or effect a short sale in that equity security for its own account, without first borrowing, or arranging to borrow, the security until the Participant closes out the fail to deliver position by purchasing securities of like kind and quantity, and that purchase has cleared and settled at a registered clearing agency. This requirement is known as the “Penalty Box” provision. As stated by the Commission, this provision is “intended to act as an additional incentive to broker-dealers to deliver securities by settlement date, and to close out fail to deliver positions in accordance with the requirements of Rule 204.”<sup>24</sup> Absent relief, Participants would be required to close out any fail to deliver positions resulting from the sale of owned physical securities pursuant to Rule 204(a)(2) and, if they did not, would be subject to the Penalty Box provision.

We believe that, due to DTC’s intermittent suspension of physical securities processing, sales of owned physical securities raise policy considerations that warrant granting limited exemptive relief.<sup>25</sup> Moreover, requiring compliance with the Rule 204(a)(2) close-out requirement may create undue burdens for Participants and other broker-dealers for which they clear and settle trades, and we do not believe that subjecting Participants or other broker-dealers to the Penalty Box provision in this context would further the policy goal of incentivizing broker-dealers to deliver securities by settlement and to close out fail to deliver positions in accordance with Rule 204. Thus, we believe that the temporary relief from the close-out requirement of Regulation SHO provided by this Exemptive Order is appropriate in the public interest and consistent with the protection of investors.

Accordingly, *it is further ordered*, pursuant to Section 36 of the Exchange

Act,<sup>26</sup> that a Participant is exempt from the close-out requirement of Rule 204(a)<sup>27</sup> and the Penalty Box provision of Rule 204(b)<sup>28</sup> of Regulation SHO with respect to a fail to deliver position resulting from the sale of an owned physical security,<sup>29</sup> subject to the following conditions:<sup>30</sup>

(a) The Participant must determine and document that the fail to deliver position resulted from a sale of an owned physical security<sup>31</sup> that a person is “deemed to own” pursuant to Rule 200 of Regulation SHO;<sup>32</sup>

(b) The Participant must check DTCC systems on a daily basis to determine when an owned physical security, the sale of which resulted in a fail to deliver position, is available for settlement;<sup>33</sup>

(c) The Participant must deliver the owned physical security as soon as

<sup>26</sup> See *supra* note 16.

<sup>27</sup> 17 CFR 242.204(a).

<sup>28</sup> 17 CFR 242.204(b).

<sup>29</sup> Rule 203(b)(3) of Regulation SHO provides that if a Participant has a fail to deliver position at a registered clearing agency in a threshold security, as defined by Rule 203(c)(6), for thirteen consecutive settlement days, the Participant shall immediately thereafter close out the fail to deliver position by purchasing securities of like kind and quantity. If the sale of an owned physical security resulted in a fail to deliver position in a threshold security and that fail to deliver position persisted for thirteen consecutive settlement days because the close-out date applicable under this Exemptive Order had not yet arrived, Rule 203(b)(3) would nonetheless require the Participant to close out the fail to deliver position. Accordingly, Participants are exempt from the close-out requirements of Rule 203(b)(3) with respect to fail to deliver positions in threshold securities resulting from sales of owned physical securities, provided that the Participants close out the fail to deliver positions in compliance with this Exemptive Order. See 17 CFR 242.203(b)(3).

<sup>30</sup> These conditions are designed to (1) promote the prompt delivery of securities by participants as soon as practical under the circumstances surrounding COVID-19 without putting undue burdens on participants or their customers, and (2) aid in ensuring participants’ compliance with this Order.

<sup>31</sup> Such determination could be based, for example, on records indicating that the sale involves a physical certificate custodied at DTCC.

<sup>32</sup> 17 CFR 242.200.

<sup>33</sup> We understand based on conversations with SIFMA that processing for certain securities may resume prior to that for others. As such, this determination must be made on a security-by-security basis. We further understand that DTC systems (including the Participant Browser System and the Participant Terminal System) enable Participants to verify their positions in physical securities held at DTC and issue withdrawal instructions. We understand that these systems permit Participants, in conjunction with the Participant’s own books and records, to track when physical securities have been debited (withdrawn) and sent to the transfer agent and when the physical securities are available for settlement after they have been returned to DTC and are available for Participant pickup, are mailed directly to the customer, or are set up as a Direct Registration System account, and that Participants check these systems for completed status of physical certificate processing on a daily basis.

possible, and in any event, must deliver the security or close out the fail to deliver position resulting from the sale by purchasing or borrowing securities of like kind and quantity by no later than the beginning of regular trading hours on the fourth settlement day following the date on which the Participant determines, in accordance with condition (b) above, that the owned physical security, the sale of which resulted in the fail to deliver position, is available for settlement;

(d) The Participant’s books and records must reflect that it made delivery of the owned physical security or closed out the fail to deliver position resulting from the sale within the applicable time period, consistent with this Exemptive Order;

(e) The Participant must maintain contemporaneous records reflecting any reliance on this Order, and make this information available to Commission staff upon request; and

(f) The participant provides notice on its website promptly upon its initial reliance on the Order and maintains the notice on its website until it ceases reliance on the Order.

### III. Modification, Revocation, and Expiration of Exemptions

The relief provided in this Order shall expire on December 31, 2020. The Commission intends to continue to monitor the current situation. The time period for any or all of the relief may, if necessary, be extended with any additional conditions that are deemed appropriate, and the Commission may issue other relief as necessary or appropriate.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>34</sup>

**Jill M. Peterson,**

*Assistant Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release Nos. 33–10826; 34–89671/August 26, 2020]

### Order Making Fiscal Year 2021 Annual Adjustments to Registration Fee Rates

#### I. Background

The Commission collects fees under various provisions of the securities laws. Section 6(b) of the Securities Act of 1933 (“Securities Act”) requires the Commission to collect fees from issuers

<sup>34</sup> See 17 CFR 200.30–3(a)(11).

<sup>23</sup> 17 CFR 242.204(b).

<sup>24</sup> Rule 204 Adopting Release at 38275.

<sup>25</sup> These policy considerations are similar to those considered in the context of the 2012 Hurricane Sandy Order. See *supra* note 6.