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By Electronic Submission to pubcom@finra.org

Jennifer Piorko Mitchell
Office of the Corporate Secretary
Financial Industry Regulatory Authority
1735 K Street, N.W.
Washington, D.C. 20006-1506

Re: Short Interest Position Reporting Enhancements and Other Changes Related to Short Sale Reporting

Ladies and Gentlemen,

Better Markets, Inc. (“Better Markets”)¹ appreciates the opportunity to comment on the Financial Industry Regulatory Authority’s (“FINRA”) proposal to improve short-selling transparency in the U.S. securities markets.² We support all of FINRA’s proposed improvements to short-interest transparency and recognize limitations with respect to the scope of FINRA’s responsibilities within the Securities and Exchange Commission’s (“SEC”) short-selling framework. Nevertheless, the proposal must be extended in significant ways discussed *below*. As it stands, the proposal would not ensure sufficiently timely and comprehensive short-interest transparency. Nor would it create the informational basis and supervisory mechanisms to detect, punish, and deter order-marking and other reporting-related practices that have led to data-reliability issues and obscured the extent of abusive or unlawful short-selling in the U.S. securities markets.

I. Recent events demonstrate the need for fundamental reforms to the regulatory framework governing short selling. The proposal stops far short of such reforms. It nevertheless proposes four positive, albeit incremental, changes to FINRA’s short-interest reporting framework.

The recent trading frenzy in Gamestop and other so-called “Reddit Rebellion” stocks has brought attention to numerous longstanding deficiencies in the transparency framework, regulatory guardrails, and operational practices governing short selling in our securities markets. In that context, FINRA’s proposal is a limited short-sale transparency (reporting) proposal. Although it would be directionally positive in all respects, it would not, and is not intended to, comprehensively address critical regulatory or operational issues that continue to plague the U.S. securities markets. For example, the proposal would do nothing to address buy-in processes, timelines, and penalties associated with routine failures-to-deliver (“FTDs”), a

¹ Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system, one that protects and promotes Americans’ jobs, savings, retirements, and more.

² See FINRA, *Short Sales: FINRA Requests Comment on Short Interest Position Reporting Enhancements and Other Changes Related to Short Sale Reporting*, Regulatory Notice 21-19 (June 4, 2021).

legacy feature of the U.S. securities settlement system that could be remedied with readily available technology.

Even with the proposed enhancements to the reporting framework, monitoring and enforcement of short-selling abuses and unlawful practices would continue to be challenging due to multiple factors, including the deliberate flexibilities and ambiguities built into U.S. regulatory standards. To be sure, FINRA has a limited role in establishing and interpreting those standards. But it can and must work aggressively within the SEC's short-selling framework, and with the SEC itself, to improve transparency, increase market stability and efficiency, reduce operational risk, and prevent abusive trading and manipulation arising from short-selling activities. The proposed transparency measures are a reasonable starting point, but they cannot be the sole end.

I. FINRA's proposal to consolidate and publish short-interest reporting for all securities would be sensible, impose almost no cost of reporting firms, and reduce informational costs for investors.

Better Markets supports FINRA's proposal to consolidate publication of short-interest data that is reported to FINRA on listed and unlisted securities (currently, FINRA disseminates short-interest data solely for over-the-counter equity securities).³ Under the proposal, FINRA would provide free access to the short-interest files on all equity securities, while requiring no change to broker-dealer reporting practices. The proposal would increase information available to *all* investors and reduce the costs of obtaining such information for *some* investors that purchase this short-interest data from each of the listing exchanges.

The public and the markets are likely to substantially benefit from consolidation of short-interest information on the FINRA website. The public may be more likely to trade and/or invest on the basis of the information otherwise hidden from their view or unequally distributed. The markets may be more efficient on account of the widely disseminated information. Despite the value to investors and markets, however, one or more exchanges directly or indirectly are almost certain to object to this consolidation and dissemination of information. This is because FINRA's proposal, if enacted, would jeopardize revenues derived from the short-interest data on listed securities currently disseminated by the exchanges. Those narrow commercial interests do not approximate, much less outweigh, the substantial benefits to investors and markets.

II. FINRA's proposed reporting fields and related content would improve short-selling transparency at minimal cost to member firms and with substantial benefits to investors.

With respect to the content of reported short-interest information, Better Markets believes that the critical consideration must be whether the information is timely, comprehensive, and clearly and usefully presented. Although much more needs to be done, FINRA's transparency proposal takes steps in the right direction.

Separate Reporting for Proprietary and Customer Accounts

First, we fully support FINRA's proposal to separate the reporting of short-interest information for proprietary and customer accounts. Each account-class would provide noisy but useful indicators of short

³ *Id* at 3. FINRA Rule 4560 requires firms to report short positions in all equity securities (other than Restricted Equity Securities) to FINRA. FINRA members are required to report short positions in both OTC equity securities and exchange-listed equity securities. However, FINRA currently only disseminates on the FINRA website short interest information for OTC equity securities. For exchange-listed securities, FINRA provides the reported short interest position information to the applicable listing exchange for processing and publication.

sentiment and provide FINRA more useful information for oversight of Regulation SHO and other short-sale obligations. Investors, too, would have an informational basis to distinguish between proprietary short positions—which reflect some market-making activities (unlikely indicative of negative sentiment with respect to a security), as well as outright speculative trading activities (more likely indicative of negative sentiment)—and short sentiment in retail accounts (most likely indicative of negative sentiment). Differentiating between these account classes empowers investors to discount short selling reflected in proprietary accounts and better enables FINRA to oversee member compliance with the short-sale framework.⁴

Position Accountability

FINRA’s proposal should be extended in several respects. For example, FINRA should require special *public* reporting (position accountability) of any customer sub-account that exceeds a specified threshold of the tradeable securities for an individual issuer. Such public reporting need not identify the specific customer account in question; merely that such a customer account and short position exists in a specific security.

More Granular Reporting for Proprietary and Retail Accounts

More granular reporting of short-positions and volumes should be made available to FINRA and the public. We would support some delineation of market-making versus proprietary trading-related short activities conducted *within* proprietary accounts as well as some differentiation between retail and institutional investors *within* other accounts. At the same, we recognize certain challenges likely to arise in policing the categorization of trading in this manner, as well as the technical mapping exercise that would need to be conducted to implement a more granular reporting framework. Therefore, we think it reasonable to create two phases for short-interest reporting improvements: (1) a Phase 1 compliance date with the identified improvements (proprietary versus retail) in the proposal; and (2) a Phase 2 compliance date with a more granular (useful) taxonomy.

Derivatives, Like Total Return Swaps, Used to Gain Short Exposures

FINRA must extend the scope of short-interest reporting to all derivatives used to gain short exposures. Logically, all so-called “synthetic” shorts must be included in short-interest reporting, including short positions arising from options and derivatives. Yet, FINRA neglects to discuss short positions arising from non-options derivatives, like total return swaps. The failure to include the full scope of short positions in reporting would incentivize member firms to shift their activities into other types of derivatives (those not covered by the synthetic short reporting rules), which not only obscures short interest but introduces new kinds of risks to broker-dealers and markets.

Although it is correct that net positions associated with such derivatives-based short positions (which might be legs of a multi-legged strategy) may result in a reduced long exposure as opposed to solely a short exposure, we think, on balance, this information remains useful to investors in contextualizing all trading activities (both long and short) in the markets and identifying potential sources for short pressure on securities regardless of the net positions involved.

Interaffiliate Arrangements

⁴ Because risk and other systems already distinguish proprietary and customer accounts, FINRA’s proposal would likely impose a very minimal redesign of logic based on existing account categories. The benefits to investors and markets far outweigh such minimal compliance and reporting costs.

FINRA must increase the transparency of interaffiliate arrangements, like arranged financing transactions, that can obscure the short-interest in individual securities. As FINRA correctly notes, “[w]hen a customer closes-out a short position by delivering shares borrowed from a [FINRA] member’s affiliate, the customer acquires an obligation to deliver shares to the affiliate in the future” and the “exposure from this loan obligation is substantially equivalent to a short position” despite remaining non-reportable.⁵ In addition, as FINRA rightly acknowledges, much of the arranged financing activities likely relate to “market participants wish[ing] to avoid disclosure,” and a reporting framework for such obligations therefore may “shift some borrowing activity away from arranged financing.”⁶ However, as FINRA surely also recognizes, a member’s continued reliance on an avenue for regulatory arbitrage is hardly a public-interest imperative, much less a legally cognizable rationale for exempting affiliate transactions from reporting requirements.

The Public Float and Other Context

FINRA must include contextual information, like total shares outstanding and the public float along with the short-interest reporting information. In addition, it should include a threshold security field that would better inform investors as to the level of FTDs in the security and make such information more easily and broadly available. Including such information in the FINRA reporting would be beneficial to investors with no discernable impact on the broker-dealer themselves or their reporting obligations.

More Frequent and Timely Reporting and Dissemination

FINRA’s proposal to increase the filing frequency and processing times for short-interest reports represent critical improvements to the current short-sale transparency framework. Both short-interest and short-sale volume reporting should be required daily on a delayed T+1-reporting basis. Each provides distinct information on the markets but is complementary to the other. We would have to understand better the operations involved in FINRA’s additional time delay for “processing” data (as the accuracy of publicly reported information is essential given that investments may be made or reallocated on the basis of the daily short-sale reports). That said, the process must be automated with substantial penalties for incorrect reporting. We emphasize that FINRA should conform whatever controls framework it uses to the daily reporting framework, not rationalize delays in reporting due to its controls.

There undoubtedly will be an industry refrain about the supposed costs associated with the daily reporting framework. We encourage FINRA to remain focused on the fact that appropriate risk management of short-sale practices and services and compliance with Regulation SHO and other requirements essentially already *demand* that member firms have in place automated systems to track and maintain current data in downstream risk and reporting systems. There would be minimal costs to configure systems to a daily short-interest reporting framework, to be sure, but cost estimates are likely to be exaggerated and the benefits of moving short-interest transparency into the 21st century are immense and undeniable.

Failure to Deliver Allocation

Better Markets supports any effort by the SEC and FINRA to reduce and deter FTDs. While a discussion of the necessary improvements to our clearing system are beyond the scope of this letter, upon issuance of an FTD notice, FINRA apparently must engage in a manual process to inquire with the clearing

⁵ See FINRA, *Short Sales: FINRA Requests Comment on Short Interest Position Reporting Enhancements and Other Changes Related to Short Sale Reporting*, Regulatory Notice 21-19, at 10 (June 4, 2021).

⁶ *Id.*

firm involved whether some allocation of the FTD has been made to a correspondent firm. Such firm-specific outreach without mandatory reporting of these allocations makes little sense as a matter of practice, common sense, and resource-use both for FINRA and member firms.

III. Conclusion

Better Markets supports FINRA’s proposal, which represents constructive first steps to improve *reporting* fully within the power of FINRA to implement. However, the SEC and FINRA together must address numerous regulatory and operational issues relating to short-selling practices in a manner that goes far beyond the present reporting proposal. In other words, FINRA’s proposal, while directionally very positive, does far too little to address the distortive effects that short-selling activities often have on capital formation and allocation.

Sincerely,



Joseph R. Cisewski
Senior Derivatives Consultant and Special Counsel

Better Markets, Inc.
1825 K Street, NW
Suite 1080
Washington, DC 20006
(202) 618-6464
jcisewski@bettermarkets.com
www.bettermarkets.com