September 30, 2021

Jennifer Piorko Mitchell
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506
pubcom@finra.org

Re: Regulatory Notice 21-19, Short Interest Reporting

Dear FINRA:

Thank you so much for addressing this important topic. The large number of responses that you have received show how important this topic is to investors. In summary:

- Information is valuable intellectual property. Such property rights should only be breached when there is an overriding public interest. In the case of short selling, there is.

1 All opinions are strictly my own and do not necessarily represent those of Georgetown University or anyone else. Over the years I have served as a Visiting Academic Fellow at the NASD, served on the boards of the EDGX and EDGA exchanges, served as Chair of the Nasdaq Economic Advisory Board, and performed consulting work for brokerage firms, stock exchanges, market makers, and law firms. I’ve also visited over 75 stock and derivative exchanges around the world. As a finance professor, I practice what I preach in terms of diversification and own modest holdings in most public companies, including brokers, asset managers, market makers, and exchanges.
We retail investors should have timely access to aggregate daily short interest through FINRA. This will help to level the playing field between individual and institutional investors.

The SEC should fix the instructions to Form 13F to treat short holdings the same as long holdings.

FINRA should work with the SEC on better transparency in the stock lending market. This will help asset owners, both institutional and retail, to retain more of the value from the securities they lend.

Introduction

FINRA is seeking comment on a series of proposals related to short selling and FINRA Rule 4560.\(^2\) Short selling is an important necessity in modern capital markets, as it facilitates the arbitrage that, among other things, keeps retail ETF prices properly aligned with their constituent assets. Arbitrage also keeps derivative prices aligned with their underlying assets. It also makes it easier for market makers to provide liquidity. Furthermore, the ability to sell short facilitates the incorporation of all information, positive and negative, into stock prices, making their prices a better reflection of their underlying value.

Short sellers who bring truthful information to the market are doing us all a favor. An overpriced stock is nobody’s friend. Eventually, the bad news will come out and the overpriced stock will fall. Investors who buy the overpriced stock, including innocent bystanders in index funds, will experience losses. By reducing the overpricing, short sellers are doing a big favor to investors like me in index funds.

Information is valuable intellectual property. It is costly to create information. Expropriating peoples’ personal financial information should only be done when there is an overwhelming public purpose. In the case of short selling, there is. The amount of short interest in a stock is extremely value relevant. Many academic studies have shown that stocks with high short interest, on average, have lower returns than other stocks.\(^3\) Better disclosure of short interest will allow this important information to be incorporated faster into stock prices, leading to more accurate market.

High levels of short interest are indicative of a “crowded trade” in which too many investors are following the same investment strategy. Crowded trades usually end badly with losses to investors amidst a disruption to a fair and orderly market. The GameStop episode is a case in point.\(^4\) Better and more timely disclosure of aggregate short interest can alert investors and regulators to brewing problem areas.

\(^2\) https://www.finra.org/rules-guidance/notices/21-19#notice


Institutions already have access to expensive information on the daily supply of shares available for lending and shares borrowed, a proxy for short interest. In general, this information is not readily available to retail investors and regulators. Providing better retail access to stock-by-stock short interest will help to level the playing field and increase investor trust in the integrity of the market. I would like to echo what Jared has said in his succinct comment letter: “I believe this is a great idea to add transparency to the market place, and to add more TRUST to the market as well.”

Even though short selling is an important part of our capital markets, there are abusers who use short selling to manipulate prices, or worse, actively seek to damage productive enterprises to profit from a short position. Not every short seller is an angel. There have been shorts who disseminate false or misleading information about their targets. Even worse, there are shorts who actively seek to interfere with the operations of the companies they have shorted and are willing to kill people to do it. Perhaps the worst example is that of the famous Contac poisoning case. Edward Arlen Marks put rat poison into packages of Contac cold medicine and then hoped to profit from the negative publicity by purchasing large quantities of put options on the manufacturer’s stock. He was caught and convicted upon the tip of an options trader who noticed unusual trading in the put options. However, no one was ever convicted of murder in the famous Tylenol poisoning cases. Was that also a scheme motivated by potential short selling profits? There are many other anecdotal stories about manipulative false information disseminated by short sellers.

Due to the possibilities for such abuse, it is indeed important for there to be good transparency and a good audit trail around short selling. Better information about holders of massive short positions will help to uphold the market’s reputation for integrity.

On the other hand, there are many situations where issuers have blamed short sellers when the short sellers were correct in pointing out fraud, such as in the case of Enron. It is often difficult for investors to determine the truth amidst the media storms during the colorful battles that rage between short sellers and long investors. Having better information about short interest will help investors better interpret information releases during such battles.

---

5 https://www.finra.org/rules-guidance/notices/21-19/comment/jared-comment-regulatory-notice-21-19


7 For an update, see http://www.pbs.org/newshour/updates/tylenol-murders-1982/

Aggregate daily short interest should be released daily through FINRA.

Brokers currently report short interest twice a month on a stock-by-stock basis and the data are made available to the public via the NYSE, Nasdaq, and FINRA. By the time this information is collected and disseminated, much time has elapsed. Retail investors are thus making investment decisions based on stale data, which at times is more than two weeks old. Markets move much faster than that!

Information technology has improved significantly in the years that have elapsed since short-interest reporting began, and our brokers are now much more automated. As brokers already have procedures in place to do the short interest reporting, the additional cost to doing the reporting more frequently should be quite modest. The report is essentially little more than an SQL query of the firm’s databases which can be automated to run daily.

As the aggregate stock-by-stock data do not indicate the holders of the short positions, there is little need to delay release of the data to protect them from anti-short vigilantes. The data should be released in a timely manner with as little delay as possible on the FINRA side. Our exchanges finish after-hours trading by 8PM. If brokers report end-of-day short-interest by 9PM, FINRA should be able to consolidate the data and release it by midnight as part of the daily post-trade processing operations.

Indeed, doing it daily makes it a regular part of routine automated brokerage and FINRA operations rather than an occasional event that firms have to schedule for special attention every month due to the changing nature of the bi-monthly reporting dates.

Consolidating the data through FINRA is in line with the SEC’s recent actions to create a single NMS plan for market data. As FINRA regulates broker-dealers, FINRA is the natural entity to collect, do quality control, and disseminate short-interest data. Having to go to three places to get the data for stocks that trade in the same country really makes little sense.

Please include total shares outstanding, float data, and threshold flag.

I support the proposal to include total shares outstanding and float measures in the data dissemination. While we retail investors can get such data from other sources such as SEC filings, it is often stale. Including up-to-date information with the aggregate short interest will reduce mistakes in calculating the level of short-interest related to shares outstanding and float.

Likewise, including the threshold flag would also be useful to investors as it would alert us to stocks with extended fails to deliver. Such stocks tend to be very hard to borrow. While the threshold data is available on exchange web sites, it is scattered over several web sites. Including it with the short-interest-data will make it easier for data intermediaries such as web sites to access and distributed the data and for investors to find it.
Getting rid of the arranged financing loophole is a good idea.

The proposal points out that short positions resulting from arranged financing may not be getting reported in the short interest data. Closing this loophole is a good idea as it would make the reported short interest more accurate.

Categorization would be nice to have, but could be problematic.

We finance professors and the media have done a disservice to the public in the way we usually teach short selling. The typical example is that of a speculator actively seeking to profit from an expected decline in the price of a stock. Such “directional” short selling is actually a very small part of total short selling activity. One of the most important findings (to me, at least) from the Reg SHO pilot was that the majority of short sales are liquidity-providing sales above the quote midpoint, indicative of stabilizing market making, and not liquidity taking at the bid price. By teaching short selling in such a way, we create the mistaken impression that the standard and most common use for short selling is an active bet against the price of a stock.

It would be nice to document on a regular basis how much short selling is related to legitimate market making, how much to arbitrage of ETFs, ADRs, and derivatives. The rest would presumably be directional. This would go a long way to dispelling the false myth that all short sellers are evil blood sucking vipers conspiring to destroy the world. However, it may be very difficult for brokers to determine the actual category of each short sale, so I am skeptical that the costs will outweigh the benefits. Indeed, it is likely that the categorization will end up being very fuzzy and of little practical use.

Other data should only be collected when needed.

I am less convinced of the benefit of collecting more granular data from member firms on an account-by-account basis just in case FINRA would like to use it for enforcement purposes. Much information on short selling is already available to FINRA through the Consolidated Audit Trail (CAT). While clearly FINRA and the SEC need access to the data in the light of specific enforcement cases, it is costly to

9 For my academic friends: I find that a much more effective teaching example is that of a merger arbitrage case in which the acquiring company pays for the target company with stock. The takeover arbitrageur shorts the acquiring company to hedge the risk that the acquirer’s stock may go down. The short does not want the acquiring stock to go down. Indeed, a collapse of the acquiring company’s stock price would likely endanger the merger and could destroy the expected profit from the arbitrage.

produce such data for all members and for all firms “just in case.” Here the question is one of whether it is less costly overall to society (for both members and regulators) to dump all the data every day versus only requesting and producing it in specific cases when needed. More information is needed to figure out the best approach.

Furthermore, there is the ever present risk of cyber breeches, as well as the financial privacy issues involved. Here in the US we believe that government authorities should have a probable cause before engaging in searches. While FINRA is technically an SRO, in practice it is viewed by many as a quasi-governmental entity. Casting a dragnet to devour massive quantities of private data “just in case” is an overreach. FINRA should stick to requesting the more granular data on an as-needed basis.

**It is sensible to report allocations of fails-to-deliver only to FINRA.**

A failure to deliver occurs when a seller does not deliver shares on the regular settlement date of T+2. Failures indicate either an operational glitch or unusual market conditions. In either case, FINRA has a legitimate regulatory interest in finding out what is going on. Many firms clear their trades through a clearing firm rather than participate directly in DTCC. When a large clearing firm fails to deliver, it can allocate that fail to one of the firms it clears for. FINRA needs to know who is actually failing to deliver. I support this proposal.

**Short holdings should be treated the same as with long holdings for purposes of 13F filings.**

Even though I am not convinced that FINRA needs more granular data, I strongly support efforts to improve transparency around large short positions through the Form 13F filing process. The same arguments apply to disclosing long positions also apply to large short positions. This, however, is mostly an SEC matter.11

**More transparency is badly needed in the stock lending market. Yes, PLEASE explore a reporting framework.**

FINRA also asks whether “FINRA should explore creating a reporting framework around stock lending activity?” The stock lending market is highly opaque to most asset owners, both institutional and retail. This means that we have no idea how good a job our brokers and agents are doing when they lend out our shares. Better transparency will give institutions and individuals a better ability to judge the value and performance of their stock lending programs. This means that more of the benefit of stock lending will accrue to the actual owners of the assets.

---

11 See my comment letter on Rule 13F, available at [https://www.sec.gov/comments/s7-08-20/s70820-7860404-223966.pdf](https://www.sec.gov/comments/s7-08-20/s70820-7860404-223966.pdf)
Better transparency for stock lending will also result in fairer treatment of stock borrowers. Better transparency will likely reduce the currently wide dispersion of rebate rates, while making it easier to locate shares for borrowing at a fair market rate.

FINRA has the experience and the expertise to design reporting frameworks. While it may take SEC action to force the needed transparency, the process will go much better if FINRA prepares the exploratory footwork. PLEASE explore a reporting framework.

Respectfully submitted,

James J. Angel, Ph.D., CFP®, CFA
Georgetown University