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September 24, 2021

Jennifer Piorko Mitchell
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

Re: Regulatory Notice 21-19, *Short Sales: FINRA Requests Comment on Short Interest Position Reporting Enhancements and Other Changes Related to Short Sale Reporting*

Dear Ms. Mitchell:

CFA Institute[1] is writing in response to the above mentioned request for comment ("Notice").[2] CFA Institute speaks on behalf of its members and advocates for investor protection and market integrity before standard setters, regulatory authorities, and legislative bodies worldwide. We focus on issues affecting the profession of financial analysis and investment management, education and competencies for investment professionals, and on issues of fairness, transparency, and accountability of global financial markets.

FINRA is considering changes to the content, frequency, and dissemination of its short interest reporting requirements (Rule 4560). FINRA believes that the potential changes could improve the usefulness of short sale-related information to FINRA, other regulators, investors and other market participants.

EXECUTIVE SUMMARY

FINRA requests comment on several amendments to its short sale reporting program. We discuss most but not all of these proposals and do so in the order in which they appear in the Notice.

CFA Institute has long recognized the benefits of short selling, including enhancing market liquidity and price efficiency.[3] We support regulatory efforts against abusive short sale practices, without hampering legitimate short activities.

Enhanced public disclosures would respond to investor demand for more information on short selling and short interest. Moreover, added transparency could help to address apparently high levels of mistrust of short sellers and suspicions that markets are rigged. Mistrust, however, should not serve as motivation to single out short sellers with disclosures that would be inequitable compared to the rules for long positions.

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[1]CFA Institute is the global association of investment professionals that sets the standard for professional excellence and credentials. The organization is a champion of ethical behavior in investment markets and a respected source of knowledge in the global financial community. Our aim is to create an environment where investors' interests come first, markets function at their best, and economics grow. There are more than 170,000 CFA charterholders worldwide in 164 markets. CFA Institute has nine offices worldwide and there are 161 local societies.
[2] FINRA, Regulatory Notice 21-19, Short Sales: FINRA Requests Comment on Short Interest Position Reporting Enhancements and Other Changes Related to Short Sale Reporting, (June 4, 2021) ("Notice").
[3] *See infra* Introduction for more.

We have sought to balance these considerations in formulating our views, which we summarize briefly here and in the chart on page 4.

FINRA is considering expanding publication on its website of short interest data to include listed equity securities. Currently FINRA posts the data for over-the-counter (OTC) equity securities only, while giving data on short interest for exchange-listed securities to the applicable exchange for public dissemination. Both Nasdaq and NYSE charge for some or all of the data they provide. We believe that FINRA should post short interest data for all equity securities, both listed and OTC, on its own website.

Several of the proposed amendments would affect the content of the data reported by broker-dealers to FINRA. For example, FINRA currently collects aggregate short interest information for equity securities and is considering requiring further breakdowns of the data. One breakdown would segregate total reportable short interest into two categories—short interest held in their proprietary accounts and that held in customer accounts.

Public reporting of this information would add transparency to the market, respond to investor demand for more information, and address mistrust of short selling. The proposed categorization, however, would provide only a rough approximation of negative market sentiment. Therefore, if FINRA chooses to adopt this disclosure requirement, it should seek to limit expectations.

FINRA also asks whether it should require even more granular content, including categorizing short sale interest as either retail or institutional, market maker or non-market maker, and the portion that is partially or fully hedged.[4] Greater granularity would enhance transparency and add to the total mix of information, but could also pose potential risks to short sellers and markets. Moreover, we are unaware of any comparable requirements for granular disclosures of long positions. This suggests a regulatory disparity that could be perceived as inequitable treatment of short selling relative to long sales. On balance, we do not believe that FINRA has made the case to justify requiring more granular disclosures.

Alternatively, FINRA is considering requiring firms to report short interest position information at the account level. Importantly, FINRA would use this information for regulatory purposes only and would not disseminate it to the public. The proposed reporting would obviate the need for FINRA to take extra steps to request data on a case-by-case basis to investigate suspected securities violations. We support confidential, non-public reporting of account-level short positions for regulatory purposes only. FINRA should use the information for its own regulatory oversight and share the data on a non-public basis with the SEC.

FINRA proposes to require firms to reflect synthetic short positions in their short interest reports. In theory, economically equivalent short positions generally should be subject to the same reporting requirements. In practice, however, it is difficult to see how a broker-dealer could identify its customers' synthetic short positions, especially if a customer used several broker dealers. Nonetheless, if the challenges could be overcome, we would support reporting of aggregated synthetic short interest as a matter of principle.

FINRA proposes to close a loophole that allows broker-dealers and their customers to avoid short interest disclosures under arranged financing programs. We support this change to capture short positions resulting from arranged financing.

[4] FINRA also asks whether broker-dealers could ascertain such information with respect to their customers' short positions. *See* Notice *supra* note 2 at 14.

FINRA is considering including information on a security's total shares outstanding and its public float, where available, in the short interest data that it disseminates. We favor this step to enhance investor understanding of the relative scale of short interest in any given stock.

FINRA requests comment on the frequency and timing of reported short interest data. Specifically, FINRA is considering increasing the required frequency from twice a month to either weekly or daily. In addition, FINRA is considering reducing the lag time before public dissemination of the data from seven to five business days.

Increasing the frequency could present a trade-off between the benefits of more timely information and heightened risks to short sellers and markets. In the past, we have advocated weekly reporting as the best way to balance the trade-offs. We maintain that view, with one caveat. We understand that certain firms already sell accurate and substantially complete aggregate short sale position data on a daily basis, but at prices that would exclude many individual investors.[5] If FINRA confirmed this is true, it would strengthen the case for mandatory daily reporting to level the playing field for all investors.

FINRA requests comment on a potential rule to require participants of a registered clearing agency to submit a report (for regulatory purposes only and not for public dissemination) of daily allocations to correspondent firms of fail-to-deliver positions (FTDs). FTDs can undermine investor confidence and pose systemic risks. Therefore, we support this proposal.

Finally, FINRA asks whether it should explore creating a reporting framework for stock lending activity. Greater transparency in share lending markets would benefit both institutional and retail investors. We encourage FINRA to pursue this initiative in coordination with the SEC, which has a Congressional mandate to adopt rules to enhance the transparency of security lending.

The following table summarizes our positions on these issues.

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[5] In addition, according to FINRA, "Estimates of short interest at a daily frequency based on other sources such as securities lending data are available for purchase from vendors, but may be less accurate and are not freely available." *See* Notice *supra* note 2 at 11.

CFA Institute Positions on Proposed FINRA Amendments on Short Interest Reporting			
Potential Rule	**CFA Institute Position**	**Why**	**Comments and Caveats**
Short Interest for Listed Securities			
Add information for listed securities to the short interest data on FINRA's website	Support	FINRA should post short interest data for all equity securities, both listed and OTC, on its website	This would fix an historic anachronism, in which FINRA posts OTC short interest data while providing the data for listed securities to the exchanges for public dissemination
Reporting Content			
Require broker dealers to segregate reports of aggregate short interest into two categories—proprietary and customer accounts	Support	Would indicate market sentiment, respond to investor demand, and help to address investor mistrust. But FINRA should manage expectations to explain limitations of the disclosures.	The disclosures would fail to reflect certain forms of negative market sentiment, such as underweighting portfolio components compared to benchmarks.
Require more granular content: market maker vs. non-market maker, retail vs. institutional investors, and fully or partially hedged short interest	Oppose	FINRA has not made the case that the benefits outweigh potential risks and drawbacks	Why subject short sellers to disclosure requirements not mandated for long sellers?
Require non-public reporting of short interest at the account level	Support	Would help FINRA combat abusive practices without harming legitimate short selling	Reporting should be confidential and non-public
Require aggregated reporting of synthetic short positions	Support	If the challenges in identifying synthetic short positions could be overcome, we would support this as a matter of principle	Economically equivalent positions should be subject to the same requirements. But feasibility is unclear.
Close a loophole that allows broker-dealers and customers to avoid short interest disclosures under arranged financing programs	Support	Would capture short positions that should be reported today but for a technicality	
Add information on total shares outstanding and public float to short interest data on FINRA's website	Support	Would contextualize the information by showing the relative size of short interest	
Reporting Frequency			
Increase reporting frequency from twice-monthly to weekly or daily	Support weekly reporting	Weekly reporting would strike a balance between the benefits of more timely disclosures and higher risks to short sellers	Caveat: If FINRA confirmed that accurate short sale interest data is available for sale on a daily basis, that would strengthen the case for mandatory daily reporting
Fail-To-Deliver Allocations			
Require non-public reporting of daily allocations to correspondent firms of fail-to-deliver (FTD) positions.	Support	Regulators should understand the causes of FTDs and ferret out any abuses	There may be legitimate reasons for FTDs, but high numbers of them could pose systemic risks
Share Lending			
Explore creating a reporting framework for stock lending activity	Support	Greater transparency in share lending markets could benefit both institutional and retail investors.	FINRA should coordinate with the SEC, which has a Congressional mandate to enhance the transparency of security lending

INTRODUCTION: SHORT SELLING BENEFITS MARKETS AND INVESTORS

Short selling plays a critical role in our capital markets. According to a 2014 SEC economic study, orders marked "short" accounted for approximately 49% of listed equity share volume.[6]

CFA Institute has long recognized the benefits of short selling. In a 2009 comment letter to the Securities and Exchange Commission (SEC), we observed:

> As a threshold issue, we want to reiterate our longstanding support of short selling. Both in the U.S. domestic market and in Europe, we have recognized short selling as a legitimate investment activity and one that serves a number of useful purposes for the financial markets. Among these benefits are improvements to the markets' price determination mechanisms, leading to more pricing efficiency, narrower bid-ask spreads, and greater market liquidity.[7]

Likewise, the SEC and other market experts repeatedly have noted the substantial market benefits of short selling, including enhanced liquidity and price efficiency.[8] Price discovery is a critical market function, which helps to prevent the formation of asset bubbles and protect investors from buying overpriced assets.[9] This is particularly important for ETFs, pension funds and other investors who invest passively and cannot exit positions that they believe are overvalued. By helping to reduce or prevent asset bubbles, short selling benefits all investors, including individual long-only investors. In addition, short selling plays an important role in uncovering fraud.[10]

Short sales also benefit long investors—including mutual funds, pension funds, and their individual beneficial owners—that engage in share lending to enhance their returns.[11] Conversely, as an SEC study has noted, "a reduction in short selling could mean lower returns for investors in mutual funds, pension plans, and other securities lenders."[12]

At the same time, short selling can be subject to abusive practices, including market manipulation and fraud. It is important to put the extent of these abuses in perspective. According to an SEC analysis of its enforcement actions against market manipulation over a seven-year period, only 14% of the cases

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[6] Based on data from November 2013. *See* SEC, Report of a Study by the Staff of the Division of Economic and Risk Analysis, Short Sale Position and Transaction Reporting, (June 5, 2014) ("SEC 2014 Study") at 58, available at https://www.sec.gov/servlet/sec/dera/reportspubs/special-studies/short-sale-position-and-transaction-reporting.pdf.

[7] Kurt N. Schacht and Linda L. Rittenhouse, Comment Letter to the SEC on File No. S7-08-09, Amendments to Regulation SHO, (Aug. 21, 2009), available at www.cfainstitute.org/-/media/documents/comment-letter/2005-2009/20090821.ashx.

[8] Majority Staff, US House of Representatives Committee on Financial Services, Memorandum on Feb. 18, 2021, Full Committee Hearing entitled, "Game Stopped? Who Wins and Loses When Short Sellers, Social Media, and Retail Investors Collide?", (Feb. 15, 2021) (noting that the SEC "has repeatedly noted that short selling provides liquidity and price efficiency. The SEC has, however, implemented various rules to curb *abusive* short sale practices.").

[9] John C. Coffee Jr. *et al*, Petition for Rulemaking on Short and Distort, (Feb. 16, 2020), ("Petition"), available at https://scholarship.law.columbia.edu/faculty_scholarship/2623, ("Short selling serves a critical function in the capital markets by encouraging price discovery and preventing the formation of asset bubbles.").

[10] *See* SEC 2014 Study *supra* note 6 at 10.

[11] *Id*. at 58.

[12] *Id*. at 58.

involved short sales, while 86% did not.[13] More recently, however, markets have seen a rise in "short and distort" campaigns conducted by bad actors who exploit social media and hide behind pseudonyms.[14]

The SEC and FINRA rightly have focused on stopping abusive short sale practices, while allowing legitimate short activities to take place. The proposed amendments should be designed to advance those policy objectives.

DISCUSSION OF FINRA PROPOSALS

Publication of Short Interest for Exchange-listed Equity Securities

FINRA is considering adding short interest information for listed equity securities to the information it displays on its website. We agree that it should, so that the FINRA website displays short interest data for all equity securities, both listed and OTC.

Because of a historic anachronism,[15] FINRA currently only posts short interest data for OTC securities.[16] It provides short interest data on listed securities to the applicable exchange for public dissemination. Nasdaq provides security-specific short position information on Nasdaq-listed equities to the public without charge, but charges for a market-wide data set.[17] The NYSE does not provide any short interest data on its public website, but instead charges to access or license an aggregated data product.[18]

In a May 6, 2021, hearing of the House Financial Services Committee, Brad Sherman (D-CA), Chair of the Subcommittee on Investor Protection, Entrepreneurship and Capital Markets, asked FINRA President and CEO Robert W. Cook why FINRA does not disclose the aggregate short interest data on its own website, rather than providing it to the exchanges—who, he added, often publish the data behind a pay wall.[19] That is a good question. A related question is whether FINRA gives the data free of charge to the exchanges or instead charges the exchanges for the data. FINRA should clarify the answer to that question and provide all relevant information to inform the public debate.

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[13] The study examined 273 Commission enforcement actions that involved market manipulation from 2004 through 2010. *See* SEC 2014 Study *supra* note 6 at fn 388.
[14] *See* Joshua Mitts, Short and Distort (Feb. 13, 2020) and Petition *supra* note 9.
[15] *See* Notice *supra* note 2 at 3 (explaining that the exchanges historically handled the publication of short interest data for their listed securities, and continued to do so even after short interest reporting for all equity securities was consolidated through FINRA in 2008).
[16] *See* Notice *supra* note 2 at 2 ("For OTC securities, FINRA aggregates and publishes the collected short interest data (aggregated across all firms, per symbol) on the FINRA website along with additional FINRA calculated metrics relating to short sale activity in the security (*e.g.*, days to cover)") and at 3 (listing the data fields presented on the website).
[17] Nasdaq provides security-specific short interest data on its public website without charge; i.e., website visitors can enter the ticker for any Nasdaq-listed company to see the short interest for that company. In addition, Nasdaq sells market data product that provides aggregated short interest data for all Nasdaq-listed securities. *See* https://www.nasdaq.com/market-activity/stocks/ndaq/short-interest and https://www.nasdaqtrader.com/Trader.aspx?id=ShortIntPubSch.
[18] *See* https://www.nyse.com/market-data/reference/nyse-group-short-interest.
[19] House Financial Services Committee Hearing, "Game Stopped? Who Wins and Loses When Short Sellers, Social Media, and Retail Investors Collide, Part III (May 6, 2021).

Content of Short Interest Data

Proprietary and Customer Account Categorization

FINRA currently collects, for public dissemination, aggregate short interest for equity securities, but does not require or provide further breakdowns. FINRA is considering requiring firms to segregate the total reportable short interest into two categories—short interest held in their proprietary accounts[20] and that held in customer accounts.

The Notice suggests that such a disclosure requirement could benefit both regulators and market participants. FINRA believes that the information would be useful in its oversight of Regulation SHO and other short sale obligations.[21] Should FINRA adopt this requirement, we suggest that it provide a more complete explanation of just how the categories could assist it in regulating markets. Perhaps FINRA could use the data as inputs into algorithms to identify trading patterns that suggest rule violations. We believe, however, the alternative of reporting account-specific short interest positions—for FINRA (and the SEC) but not for the public—would be more precise and useful for regulatory purposes. We discuss that option below.

FINRA also suggests that public dissemination of the proposed categorization may be useful for market participants. We agree that public reporting of this information could add to the total mix of information for investors and respond to investor demand for more information on short sales. According to the aforementioned 2014 SEC study, "Empirical studies also support the idea that short sellers are informed, suggesting that information about short selling could help investors better value stocks."[22]

Moreover, the enhanced transparency could help to address current levels of mistrust and suspicions of markets, regulators, and short sales. These suspicions come through loudly and clearly in the comment file (even if any profanities have been redacted).[23] We understand that, as late August, this Notice already had generated a record response rate of 1,800 comment letters.[24] Many of the letters expressed mistrust of hedge funds and short sellers along with perceptions of market manipulation, captured regulators, and rigged markets. If the enhanced transparency can help to dispel or reduce such mistrust, the requirement will be worth adopting.

The proposed categorization, however, would provide only a rough approximation of directional short sales based on the expectation that the stock price will fall. On the one hand, we understand that most broker-dealer proprietary short sales serve as hedges, not directional trades. Therefore, we agree with FINRA that proprietary short positions are less likely than customer short positions to represent negative sentiment. [25]

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[20] Based on our conversation with FINRA staff on August 25, 2021 ("Conversation"), we understand that proprietary accounts would cover all short sales that the broker-dealer conducts for itself in its own account, whatever the purpose (such as hedging, directional trades, etc.).

[21] *See* Notice *supra* note 2 at 8.

[22] *See* SEC 2014 Study *supra* note 6 at 50-51.

[23] *See* https://www.finra.org/rules-guidance/notices/21-19#comments.

[24] Conversation *supra* note 20.

[25] *See* Notice *supra* note 2 at 8 ("While proprietary short selling by members is not necessarily for the purposes of liquidity provision, it may correspond to this category to some degree and, therefore be less likely to reflect negative sentiment in the stock."). *See* also SEC 2014 Study *supra* note 6 at 4 (identifying three motivations for short selling, including (1) to profit from an expected downward price movement and (2) to hedge the risk of an economic long

Customer short sales, on the other hand, can be motivated by a variety of reasons. While some investors build up short positions based on fundamental research or technical analysis indicating that a stock is overvalued, other investors engage in short sales for hedging or other purposes.[26] In other words, the signal (informed directional sales) would be mixed with noise.

Moreover, investors can and do express negative sentiment in other ways besides short selling. For example, active mutual funds often manage to one or more benchmarks. When portfolio managers are bearish on a market segment, they typically underweight that portfolio component compared to the benchmark weighting. Similarly, a bearish view of the equity market as a whole could result in an overweight cash position. The proposed enhanced disclosures of short sales would fail to capture market sentiment expressed by these underweight positions.

Should FINRA adopt this requirement, we would recommend that it seek to manage expectations by explaining the limits of the categories in reflecting negative market sentiment. For example, FINRA could offer explanations in a final rule release, investor education materials, or both.

More Granular Disclosures

FINRA asks whether it should require more granular disclosures of short positions, including these:

- retail and institutional investors categories
- market maker and non-market maker categories
- the portion of short sales that are fully or partially hedged.

While we recognize that these disclosures would entail certain benefits, they could also present risks to short sellers and markets.

On the positive side, more granular disclosures could respond to investor demand for more information on short sales. For instance, the disclosures (if feasible to provide)[27] could help investors distinguish market maker and hedged short positions from other short positions more likely to represent negative sentiment. The institutional/retail category could add to the total mix of information for investors. Importantly, more granular disclosures also could help to address mistrust of short selling.

On the other hand, granular disclosures, even at an aggregate level, potentially could expose short sellers to vulnerabilities and have negative spillover effects on market quality. This would be particularly true if the granular content were paired with increased frequency of reporting, daily reporting in particular. The more granular the disclosure, and the more frequent the reporting, the greater the risks.

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position) and at 38 (distinguishing market maker short selling from potentially well-informed directional short sales).

[26] *See*, *e.g.*, SEC 2014 Study *supra* note 6 at 44 (noting that market participants "sell short for many reasons, including fundamental or technical trading, hedging, or as part of market neutral strategies such as long-short arbitrage, and thus there is the potential for misinterpretation of a given short sale or even an increase or decrease in short selling volume.").

[27] In practice, it could be challenging, if not infeasible, for broker-dealers to report their customers' hedged short interest. For example, if a customer booked short positions across multiple firms, no one dealer would see the entire position. For an analogous discussion of the challenges of reporting synthetic short interest, *see infra* at 11.

For example, increased transparency into aggregate short positions could make short sellers vulnerable to short squeezes, copycat trades or order anticipation strategies.[28] Traders may seek to use the new information to discern tipping points of impending securities purchases by short sellers who need to cover their short positions.[29] Ironically, enhanced disclosures could conceivably have the perverse effect of facilitating manipulative short selling strategies, by making it easier for bad actors to coordinate on bear raids or short squeezes.[30]

Overall, the impact of more granular disclosures on markets would be ambiguous.[31] In a best-case scenario, markets would assimilate informed negative market sentiment more quickly.[32] That would enhance market efficiency and price discovery.[33]

In a downside scenario, however, greater granularity could have a chilling effect on informed short selling. That in turn could harm market efficiency, price discovery, liquidity, capital formation.[34] Long investors, including retail investors, could become less protected from overvalued stocks or market bubbles.[35] Overvalued stocks also would make capital allocation less efficient.[36] Furthermore, broker-dealers might respond to increased risks by increasing their bid-ask spreads and decreasing liquidity.[37] Higher transaction costs also could have a negative impact on capital formation.[38]

Alternatively, the disclosures could drive short sellers into other trading strategies to disguise their short positions and avoid disclosures. That in turn could vitiate the informational value of the proposed disclosures and potentially could cause investor confusion in interpreting market sentiment.

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[28] *See* SEC 2014 Study *supra* note 6 at vi (noting a "market-maker short category "could render market makers vulnerable to order anticipation strategies, particularly in stocks with few market makers") and at 55 ("High market maker shorting volume predicts buy-to-cover activity in the near future, making market makers particularly vulnerable to squeezes if Transaction Marking makes their shorting public in real time.").

[29] *See* SEC 2014 Study *supra* note 6 at 54 (suggesting how buy-to-cover disclosures could enable traders "to predict the tipping point when prices have risen enough for a short squeeze to become effective.")

[30] *Id*. at 54 (noting that short-sale related transaction markings "could increase the effectiveness of short selling manipulation techniques because it could render coordination easier and manipulative short selling strategies more profitable") and at 97 ("Aggregated real-time short sale positions could harm price efficiency by facilitating abusive trading such as coordinated bear raids and short squeezes.").

[31] For a discussion of how constraints on short selling could affect market quality, see *Id*. at 50-58 and 79-85. Though the study examined different short-selling related disclosure reforms than those contemplated here, the analysis of potential market impact remains relevant.

[32] *Id*. at iv ("More precise and timely information about short selling could help the market adjust to new information faster, promoting price efficiency and hence capital formation") and at 51 (noting the potential for professional trading based on certain short sale information "to correct an over- or under-valuation sooner than if disclosure of short sale related marks continued to be delayed.").

[33] *Id*. at iv and 51.

[34] *See, e.g., Id.* at 55 (noting concerns that increased visibility and exposure of short sellers could lead to a potential short-term decrease in trading volume and liquidity) and at vi (noting that copycat and order anticipation strategies "could discourage both the fundamental analysis that is vital to price efficiency and hedging that facilitates capital formation").

[35] *Id*. at 10 and at fn 73.

[36] *Id*. at 13-14 (explaining how short selling restrictions could lead to overvalued stocks and inefficient capital allocation, because "overvalued companies may fund less profitable or, worse, unprofitable projects, while profitable projects could go unfunded in companies whose stock is fairly valued or undervalued.").

[37] *Id*. at 55.

[38] *Id*. at 57 (noting that decreased short selling and higher transaction costs could lead to a "potential deterioration in price efficiency [which] might also impede capital formation and capital allocation efficiency.").

As the SEC has observed, equity, options, futures, and swaps markets are interconnected.[39] As a result, "efforts to require reporting of just one product, without analogous reporting in the other, related products, may not allow the regulators or market participants to have a complete understanding of the 'negative' interest in an issuer."[40]

Finally, requirements for granular disclosures raise a policy concern over fair treatment. We are unaware of any comparable requirements for granular disclosures of long positions.[41] This suggests a regulatory disparity that could be perceived as inequitable treatment of short selling relative to long sales.
In sum, we do not believe that FINRA has made the case to justify requiring more granular disclosures.

Account-level Position Information

As an alternative to proprietary and customer account categorization, FINRA is considering requiring firms to report to FINRA short interest position information at the account level.[42] Importantly, FINRA would use this information for regulatory purposes only and not for public dissemination.
We favor this approach, because it could help FINRA to combat abusive short selling practices without harming legitimate short selling activities. Specifically, the account-level information could assist FINRA in detecting illegal trading patterns, investigating abusive short selling, and taking enforcement action. For these same reasons, FINRA should share the information on a non-public basis with the SEC.

The FINRA Notice offers a brief explanation of the benefits of the potential reporting requirement:

> Account-level short interest position information would provide FINRA with insight into the identity of the individuals or entities that accumulated concentrations of large short interest positions, which FINRA would use to enhance its reviews for compliance both with SEC Regulation SHO and FINRA's short sale rules.[43]

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[39] *Id*. at fn 47.
[40] *Id*. at fn 47.
[41] Perhaps the closest analog would be required disclosures of certain holdings by large institutional investors pursuant to Section 13(f) of the Exchange Act. *See* Pub. L. No. 94-29, 89 Stat. 97 (1975). Rule 13f under Section 13(f) requires an investment manager to file a report with the SEC if the manager exercises investment discretion with respect to accounts holding certain equity securities with an aggregate fair market value of at least $100 million. Covered securities include listed equity securities and options, but not short positions. Short positions are not required to be reported and are not netted against long positions on Form 13F. *See*, *e.g.*, SEC 2014 Study *supra* note 6 at 73.
(Specifically, the securities that must be reported under Section 13(f) generally include equity securities that are traded on an exchange or quoted on NASDAQ, equity options and warrants, shares of closed-end investment companies, and some convertible debt securities. *See* Office of the Inspector General, Review of the SEC's 13(f) Reporting Requirements (Sept. 27, 2010), at v, available at
https://www.sec.gov/about/offices/oig/reports/audits/2010/480.pdf.)
There are important differences, however, between Rule 13f disclosures and the proposed granular disclosures of short positions. Rule 13f applies only to large institutional investors, and disclosures are required only once a quarter with a permitted time lag of up to 45 days. A primary purpose of Rule 13f disclosures is to provide information about the impact of large institutional investors on securities. The proposed categorization, in contrast, could apply to all short sales and short sellers, regardless of market impact.
[42] Conceivably, FINRA could consider adopting this requirement along with the proposed disclosures on categorization and more granular disclosures discussed above. However, the Notice presents the account-specific reporting proposal "as an alternative to the proprietary and customer account categorization." *See* Notice *supra* note 2 at 14.
[43] *See* Notice *supra* note 2 at 4. FINRA adds that it is also considering possible ways to identify account holders across firms. *Id*. at 9.

We would suggest that FINRA expand on this explanation, offering a more substantive and detailed account of how it would plan to use the proposed information.

That said, we would agree that account-level information could assist both FINRA and the SEC in their surveillance, investigation and enforcement activities. We understand that neither FINRA nor the SEC currently has direct access to this information, and instead must request data on a case-by-case basis to investigate potential securities violations.[44] Direct access would obviate the need to go through this cumbersome process.

The SEC 2014 economic study on short sale disclosures clearly explains the benefits of direct access by regulators to account-specific data. Although the context was different—the study discussed the possibility of non-public real-time position reporting—we believe that similar benefits would attach to FINRA's proposed account-level position information. The SEC study found:

> Relative to currently available data, identified Real-Time Short Position Reporting could be of great help to the Commission and FINRA in facilitating investigations, monitoring and surveillance. The Commission and FINRA currently utilize, among other things, SRO referrals, tips, and complaints to identify abusive traders, and then go through a process of obtaining the necessary information to evaluate whether violations of the securities laws, including manipulation, have occurred. Having this information available more promptly, without having to obtain it on a case-by-case basis, would allow the Commission and FINRA to monitor markets more easily. This would enable them to identify suspicious activity more quickly and effectively, potentially increasing the number of leads that could result in investigations of illegal behavior.[45]

While we recognize the benefits of FINRA's proposed requirement, we also acknowledge legitimate concerns over heightened security risks that could arise from FINRA's collection and possession of account-level position information. Recent ransomware attacks on economically significant industries bring these concerns into sharp relief.[46] If account-level data were ever obtained by cybercriminals, it could do great harm to individual investors and investor trust more broadly. On the other hand, concerns over security risks should not paralyze regulators and SROs into inaction. The world has moved to big data and data analytics, and regulators must keep up. Before adopting this requirement, however, FINRA should determine with very high confidence that it can maintain the security of the data.

Synthetic Short Positions

FINRA proposes to require firms to reflect synthetic short positions in their short interest reports. In principle, economically equivalent short positions should be subject to the same reporting requirements.[47] It is difficult, however, to see how this would be feasible in practice. For example, if a customer booked positions across multiple broker-dealers, any one firm would be able to provide only an incomplete

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[44] Conversation *supra* footnote 24 and SEC 2014 Study *supra* note 6 at 29.
[45] *See* SEC 2014 Study *supra* note 6 at 110.
[46] *See*, *e.g.*, Ian Talley and Dustin Volz, Wall Street Journal, U.S. to Target Crypto Ransomware Payments With Sanctions, Wall Street Journal, (Sept. 17, 2021) and Dustin Volz, Wall Street Journal, Ransomware Targeted by New Justice Department Task Force, (April 21, 2021).
[47] Proponents also invoke regulatory symmetry to argue that Form13F disclosures should include short positions and not just long positions. That question, however, is a policy issue for the SEC, not FINRA. For more on Form 13F disclosures, see *supra* footnote 41.

picture.[48] Nonetheless, if it proved feasible, we would support requiring reports of synthetic short interest aggregated per symbol across all firms.

Loan Obligations Resulting from Arranged Financing

These arrangements take advantage of a regulatory loophole that allows broker dealers and their customers to avoid current disclosure requirements for short interest. As the Notice explains:

> When a customer closes-out a short position by delivering shares borrowed from a member's affiliate, the customer acquires an obligation to deliver shares to the affiliate in the future. The exposure from this loan obligation is substantially equivalent to a short position but the loan obligation is not a reportable short position under the current version of Rule 4560."[49]

In other words, in arranged financing, the short position ends up on the books and records of a broker-dealer affiliate who is not a member of FINRA and therefore not subject to its rules. The broker-dealer firm itself *is* subject to FINRA rules, but has nothing to report because the short position is no longer on *its* books and records.

We support FINRA's proposal to close this loophole by requiring short interest reports to reflect outstanding stock borrows by customers in arranged financing programs.

Total Shares Outstanding and Public Float

FINRA is considering adding information on a security's total shares outstanding and public float, where available, in the short interest data that it disseminates. Broker-dealer firms would not be subject to new reporting requirements, because FINRA would obtain the information from a third party.

Investors can get this information now if they search for it, and large institutions probably already have it. This proposal would help level the playing field.

The added contextual information would help market participants understand the scale of short interest in any one security. The same absolute dollar amount of short interest could represent a large percentage of the public float of a small company, but only a small percentage for a large company. Including this information could reduce the risk of investor confusion over the relative scale of short interest in any given stock. Recent market developments have shown the importance of this information. Specifically, the advent of meme stocks has demonstrated that a sizeable number of retail investors keenly follow short interest information.

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[48] *See* SEC 2014 Study *supra* note 6 at 87 ("Institutional short sellers typically use many introducing and executing brokers, who individually may have little knowledge of their clients' overall short or long position.").
[49] *See* Notice *supra* note 2 at 10. *See* also SEC 2014 Study *supra* note 6 at fn 196.

Frequency and Timing of Short Interest Position Reporting

FINRA is considering increasing the frequency of aggregate short interest position reporting by broker-dealers from twice a month to either weekly or daily. More timely information could be useful to investors in making investment decisions and to FINRA in overseeing compliance with short sale regulations. There can be significant changes in short positions over a two-week period,[50] and there is investor demand for timely information on short sale positions.[51]

Like more granular content, however, increased frequency could subject short sellers to potentially greater risks. If that constrained short selling activity, it could have harmful effects on markets, including reduced price discovery, liquidity, and capital formation.[52] Moreover, increased frequency could facilitate coordination of manipulative strategies, such as bear raids or short squeezes.[53]

Two factors mitigate the risks. First, disclosures of short interest positions would be at the aggregate level rather than the account level. Second, even with increased frequency, there would still be a time lag before public dissemination of the data. Short positions are reported as of designated reporting settlement dates, but it takes another seven business days before short interest data for OTC equity securities appear on the FINRA website.[54] FINRA is considering reducing the lag time to five business days.[55]

Even with aggregate disclosures and time lags, however, too great a frequency would entail some risks to short sellers. There is a trade-off between the benefits of more timely information and heightened risks to market participants and markets.

In the past, CFA Institute has favored weekly reporting as the best way to balance the trade-offs.[56] We maintain that view – but with one caveat. We understand that certain firms already gather, aggregate and sell accurate and substantially complete (albeit less than 100 percent) short sale interest data on a daily basis.[57] FINRA should confirm whether this is indeed the case. If so, that would mitigate concerns that a required daily reporting would harm short sellers. Furthermore, we understand that the private data is sold at a price placing it out of reach for most individual investors. If that is true, FINRA should consider

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[50] *See* SEC 2014 Study *supra* note 6 at fn 397 (estimating daily averages of 12 million short sale transactions and 24 million short position changes (including buy-to-cover transactions) based on data for the month of November 2013.)
[51] *See* Notice *supra* note 2 at 11 (citing demand for estimates of daily short interest).
[52] *See supra* footnote 34 and surrounding text.
[53] *See supra* footnote 30.
[54] *See* Notice *supra* note 2 at 5.
[55] Broker-dealers are required to report short interest information two business days after the settlement date, and FINRA then takes an additional five business days to process and post the OTC data. FINRA asks whether it should reduce the total lag time by two days (a reduction of one day each for broker-dealer turnaround time and FINRA processing time). *See* Notice *supra* note 2 at 5 and 17.
[56] Sviatoslav Rosov and Rhodri Preece, CFA Institute Comment Letter to the European Securities and Markets Authority (Sept. 4, 2017), available at https://www.cfainstitute.org/-/media/documents/comment-letter/2015-2019/20170904.ashx (advocating weekly publication of aggregated net short position by issuer on a weekly basis as a useful compromise between a monthly and a daily basis).
[57] For examples of two such products, see S3 Partners' Black App, available at https://s3partners.com/product-blackapp.html, and Refinitiv's HIS Markit - Short Interest, available at https://www.refinitiv.com/en/financial-data/pricing-and-market-data/equities-market-data/ihs-markit-short-interest. (CFA Institute does not endorse any particular products.)

whether a regulatory requirement for daily reporting would level the playing for investors unable to afford the privately sold data.

Information on Allocations of Fail-to-Deliver Positions

FINRA is considering a new rule to require that participants of a registered clearing agency submit a report to FINRA of daily allocations to correspondent firms of fail-to-deliver positions (FTDs). The reporting would be for regulatory purposes only and not for public dissemination.

While we refrain from commenting on the feasibility and operational questions arising from this proposal, we emphasize our support for regulators' efforts to understand the causes of FTDs and ferret out any abuses. There may be legitimate reasons for FTDs, but at high levels they can instill doubt in market integrity, undermine investor confidence, and pose potential systemic risks. For these reasons, it is important for regulators to understand the volume, causes, and trends involving FTDs.

Share Lending

FINRA requests comment on whether to explore creating a reporting framework for stock lending activity.[58] The framework would involve rebate rates and other transaction terms, initially for regulatory purposes only but eventually for possible public disclosure on a phased basis.[59]

We encourage FINRA to explore a framework that would provide greater transparency into share lending markets, in particular with respect to price transparency. A reporting framework could have potential benefits for both institutional and retail investors. Institutional investors typically enter into share lending contracts with their broker-dealers. Retail investors, however, may have only a murky awareness of their participation in share lending programs. Specifically, individual investors participating in share lending programs could benefit from greater clarity on the extent to which the revenues from share lending flow back to them.

Should FINRA pursue this initiative, it should coordinate with the SEC. In the Dodd-Frank Act, Congress mandated that the SEC adopt rules to enhance the transparency of security lending.[60]

CONCLUSION

CFA Institute has long recognized the market benefits of short selling, including enhanced price discovery, liquidity, and capital formation. Short selling helps to protect investors—including long-only individual investors and passively invested pension funds, mutual funds and ETFs—from overpriced securities.

Three further considerations should be taken into account. First, there is demonstrated market demand for more information on short interest, which investors can use in their investment decisions. Second, there are legitimate concerns over abuses of short selling, including market manipulation. Third, as the

[58] *See* Notice *supra* note 2 at 19.

[59] *Id*. at 19 ("For example, member firms that engage in stock lending transactions could be required to report loan terms to FINRA—*e.g.,* rebate rate (for new loans, open daily loans and re-rates), loan amount, contra-party information. After experience is gained with the reporting regime and resulting data, FINRA could consider the appropriateness of a phased approach to providing public transparency into stock loan rebate rates and other negotiated terms.").

[60] Dodd-Frank Act Section 984 (mandating that the SEC "promulgate rules that are designed to increase the transparency of information available to brokers, dealers, and investors, with respect to the loan or borrowing of securities.").

comment file on this Notice makes clear, there are unacceptably high levels of mistrust of short sellers and perceptions of rigged markets.

Regulators and SROs, including FINRA, can address these concerns by vigilantly overseeing markets, enforcing the rules, and enhancing market transparency. We note, however, that mistrust should not serve as a motivation to single out short sellers or subject them to inequitable regulations. Several of the proposed amendments appear designed to balance these considerations. We support such efforts, provided they do not have a chilling effect on legitimate short sale activities.

On behalf of CFA Institute, we thank you for your consideration and welcome the opportunity to discuss our letter with you. Please do not hesitate to contact us.

Sincerely,

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