

Short Sales

Amendments to FINRA Trade Reporting and OATS Rules to Reinstitute Short Sale Exempt Marking and to Require Price and Short Exempt Identifier on Route Reports

Effective Date: November 10, 2010

Executive Summary

The SEC has approved a FINRA rule change that, among other things, reinstitutes the short sale exempt marking category for trade reports to a FINRA trade reporting facility (TRF) or to FINRA's Alternative Display Facility (ADF) (together, "FINRA Facilities"). The rule change also requires FINRA Order Audit Trail System (OATS) route reports to include price and a short exempt identifier, if applicable.¹ The amendments are effective on November 10, 2010,² consistent with the compliance date of the amendments to SEC Regulation SHO.³

The text of the amendments are available in the *FINRA Manual* at www.finra.org/finramanual.

Questions regarding this *Notice* should be directed to:

- FINRA Operations at (866) 776-0800; or
- OATS Helpdesk at (800) 321-6273
- Racquel Russell, Assistant General Counsel, Office of General Counsel, at (202) 728-8363.

October 2010

Notice Type

- Rule Amendment

Suggested Routing

- Compliance
- Legal
- Operations
- Senior Management
- Systems
- Trading and Market Making

Key Topics

- OATS
- Short Sales
- Trade Reporting

Referenced Rules

- FINRA Rule 6182
- FINRA Rule 6282
- FINRA Rule 6380A
- FINRA Rule 6380B
- FINRA Rule 6622
- FINRA Rule 7230A
- FINRA Rule 7230B
- FINRA Rule 7330
- FINRA Rule 7440
- NASD IM-2110-2

Background and Discussion

On February 26, 2010, the SEC adopted amendments to Regulation SHO that, among other things, implement a short-sale circuit breaker for NMS stocks⁴ triggered by a 10 percent or more decrease in the price of the security from the security's closing price at the end of regular trading hours on the prior trading day. Once a circuit breaker is triggered, Regulation SHO, as amended, generally requires trading centers to establish, maintain and enforce written policies and procedures reasonably designed to prevent the execution or display of short sale orders of an NMS stock at a price that is less than or equal to the current national best bid (NBB) for the remainder of the day and the following day, unless an exemption applies ("short sale price test restriction").⁵

As amended, Regulation SHO provides several exemptions to the short sale price test restriction and sets forth provisions under which a short sale order may be marked "short exempt." These provisions include:

- broker-dealer policies and procedures;
- seller's delay in delivery;
- odd lot transactions;
- domestic arbitrage;
- international arbitrage;
- over-allotments and lay-off sales;
- riskless principal transactions; and
- transactions on a volume-weighted average price basis (or VWAP).⁶

Consistent with these amendments to Regulation SHO, FINRA is reinstituting the "short sale exempt" marking category in FINRA's trade reporting rules for over-the-counter transactions in NMS stocks. Thus, firms must indicate on trade reports submitted to a FINRA Facility if a transaction is "short exempt," consistent with Regulation SHO.⁷

In addition, the OATS rules have been amended to provide that, when an order is received or originated, firms must record the designation of the order as "short sale exempt" if the order is marked "short exempt" for Regulation SHO purposes. The amendments also require that firms include on route reports, if applicable, the price at which the order is routed and a short exempt identifier.⁸

On October 6, 2010, SEC staff issued *Responses to Frequently Asked Questions Concerning Rule 201 of Regulation SHO* (the SEC Rule 201 FAQ) that address, among other things, a firm's compliance obligations under self-regulatory organization customer order protection rules when a short sale price test restriction is in effect. In cases where a firm is short in a security and buys shares of that security during a short sale price test restriction (at a price that would trigger a fill of a customer limit order to buy under NASD IM-2110-2), SEC staff stated that the firm must fill the customer order (by selling short to the customer), regardless of whether such sale would meet the requirements of the price test restrictions of Rule 201 of Regulation SHO.⁹ The *SEC Rule 201 FAQ* further provides that, in this instance, the firm may mark the short sale order to fill the customer limit order as "short exempt."

The *SEC Rule 201 FAQ* also clarifies, among other things, that where a customer limit order to sell short at the NBB is triggered by a firm's long sale at the NBB in the same security, the firm's long sale would not require the execution of the customer's short sale limit order because the customer's limit order would not have been executable under Rule 201 (because it is a short sale priced at the NBB).¹⁰

These amendments to FINRA rules are effective on November 10, 2010, consistent with the compliance date of the amendments to SEC Regulation SHO.

Endnotes

- 1 See Securities Exchange Act Release No. 63032 (October 4, 2010), 75 FR 62439 (October 8, 2010) (Order Approving SR-FINRA-2010-043).
- 2 As noted in the *OATS Reporting Technical Specifications* dated August 30, 2010, the new fields will be required on OATS route reports beginning on November 8, 2010; however, members are not required to populate the fields until November 10, 2010. If a firm populates the fields prior to November 10, 2010, all relevant field validations will apply. Firms should consult the *OATS Reporting Technical Specifications* for more information. See also *OATS Frequently Asked Questions*, Question C85.
- 3 The amendments to Regulation SHO became effective on May 10, 2010 with a compliance date of November 10, 2010.
- 4 "NMS stock" means any "NMS security" other than an option. See 17 CFR 242.600(b)(47). Rule 600(b)(46) of SEC Regulation NMS defines "NMS security" as any security or class of securities for which transaction reports are collected, processed, and made available pursuant to an effective transaction reporting plan, or an effective national market system plan for reporting transactions in listed options. See 17 CFR 242.600(b)(46).

Endnotes

- 5 See Securities Exchange Act Release No. 61595 (February 26, 2010), 75 FR 11232 (March 10, 2010) (Adopting Release for Regulation SHO, as amended).
- 6 SEC staff has indicated that firms may use the existing weighted average price (W) trade reporting modifier to satisfy the requirement in the VWAP exception that the transaction be reported using a special VWAP trade modifier. See Rule 201(d)(7) of Regulation SHO. The use of the W modifier would be in addition to the requirement to report the trade as “short sale exempt.”
- 7 Generally, FINRA expects firms to report transactions to FINRA Facilities in a manner that is consistent with the marking of the order for the purposes of Regulation SHO. However, we understand that, in some cases, the status of an order may change between the time of order origination and execution such that the trade report is marked differently than the order (*e.g.*, a circuit breaker is triggered or the NBB changes). If the trade report differs from the order, members must be prepared to provide, upon request from FINRA, documentation or evidence as to the reason for the difference.
- 8 Whenever a firm transmits an order to another member firm, electronic communications network, non-member firm or national securities exchange for handling or execution, the routing firm is responsible for recording and reporting a route report to OATS. As amended, the OATS rules require route reports to include the price at which the order was routed, which may be different from the price received from the customer, and whether the routed order is short exempt.

The short exempt identifier is important for purposes of route reports because certain short sale orders will be eligible to be marked exempt solely as a result of the timing and price of the routed order. See Rule 201(c) of SEC Regulation SHO. As of November 10, 2010, firms are also required to indicate the order type on route reports (*i.e.*, whether the order is a limit order and, consequently, requires that the limit price be included on the route report). For a complete description of these and other changes to OATS that go into effect on November 10, 2010, firms should consult the [OATS Reporting Technical Specifications](#) on FINRA’s website.
- 9 See Question # 8.1 of the [SEC Rule 201 FAQ](#).
- 10 See Question # 8.2 of the [SEC Rule 201 FAQ](#).