

Short-Interest Reporting

SEC Approves Amendments to FINRA's Short-Interest Reporting Rule

Effective Date: November 30, 2012

Executive Summary

The SEC approved amendments to FINRA Rule 4560 (Short-Interest Reporting).¹ The amendments: (1) codify the requirement that member firms report only “gross” short interest existing in each proprietary and customer account (rather than net positions across accounts); (2) clarify that member firms’ short-interest reports must reflect only those short positions that have settled or reached settlement date by the close of the FINRA-designated reporting settlement date; and (3) delete certain existing exceptions to the rule.

The text of the rule can be found in the online FINRA Manual.

Questions regarding this *Notice* should be directed to:

- ▶ The Legal Section, Market Regulation, at (240) 386-5126; or
- ▶ The Office of General Counsel at (202) 728-8071.

Background and Discussion

FINRA Rule 4560 requires that each member firm maintain a record of total “short” positions in all customer and proprietary firm accounts in all equity securities (other than a “restricted equity security,” as defined in Rule 6420) and regularly report such information to FINRA in the manner FINRA prescribes.²

Amended Rule 4560 codifies a previously issued interpretation that states that firms must record and report short positions existing in each individual firm or customer account on a “gross,” as opposed to a “net,” basis³ (including accounts of a broker-dealer): (1) that resulted from a “short sale,” as that term is defined in Rule 200(a) of SEC Regulation SHO⁴; or (2) where the transaction(s) that caused the short position was marked “long,” consistent with SEC Regulation SHO due to the firm’s or the customer’s net long position at the time of the transaction (*e.g.*, aggregation units).

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Notice Type

- ▶ Rule Amendment

Suggested Routing

- ▶ Compliance
- ▶ Legal
- ▶ Systems
- ▶ Technology
- ▶ Trading and Market Making
- ▶ Training

Key Topics

- ▶ Short Interest
- ▶ Short Sales

Referenced Rules

- ▶ FINRA Rule 4560
- ▶ FINRA Rule 6420
- ▶ Regulation SHO



Amended Rule 4560 also clarifies that firms are required to report only those short positions resulting from short sales that have settled or reached settlement date by the close of the FINRA-designated reporting settlement date. Therefore, short positions resulting from short sales that were effected but have not reached settlement date by the given designated reporting settlement date should not be included in a firm's short-interest report for that reporting cycle. Of course, short-interest positions resulting from short sales that reached the expected settlement date, but failed to settle (*i.e.*, resulted in a fail to deliver), must be included.

Finally, amended Rule 4560 deletes three exceptions for stabilizing activity, domestic arbitrage and international arbitrage,⁵ but retains the exceptions for: (1) any sale by any person, for an account in which (s)he has an interest, if the person owns the security sold and intends to deliver the security as soon as is possible without undue inconvenience or expense; and (2) any sale by an underwriter, or any member of a syndicate or group participating in the distribution of a security, in connection with an over-allotment of securities, or any lay-off sale by such a person in connection with a distribution of securities through rights or a standby underwriting commitment.

Frequently Asked Questions

Q1. Does Rule 4560 require that all transactions marked “short” be reported as short interest?

- A1. Rule 4560 applies only to short-interest positions resulting from: (1) a “short sale,” as defined by SEC Regulation SHO Rule 200(a); or (2) a transaction that was marked “long,” consistent with SEC Regulation SHO, due to the firm's or the customer's net long position at the time of the transaction.

However, Rule 4560(c)(1) provides an exception for sales by any person, for an account in which (s)he has an interest, if the person owns the security sold and intends to deliver the security as soon as is possible without undue inconvenience or expense. Therefore, although such sales are required to be marked “short” under SEC Regulation SHO Rule 200(g), due to this exception, the positions are not reportable as short interest. For example, positions created from sales pursuant to Rule 144 that are pending the return of clean shares from the transfer agent are not reportable as short-interest even where they result from a “short sale” as defined by SEC Regulation SHO, because such sales are exempt from short-interest reporting pursuant to paragraph (c)(1).

Q2. Are “fail-to-receive” positions reportable to FINRA as short interest?

- A2. Fails to receive do not result from a “short sale” and are not reportable to FINRA pursuant to Rule 4560.

Q3. Is it permissible to report short-interest positions to FINRA where the clearing firm also reported on the member firm’s behalf, so long as FINRA receives the information at least once?

- A3. Complete and accurate short-interest information should be reported to FINRA only once. Duplicate reporting results in inaccurate short-interest position information. A firm is responsible for determining whether its clearing firm is reporting short interest on its behalf and, if so, the firm should not submit a duplicate report.

Q4. Does Rule 4560 apply to positions held by a member firm in a foreign-listed security?

- A4. Firms must report gross short positions existing in each individual firm or customer account in any equity security that has a U.S. symbol, irrespective of the exchange on which the “short sale” was executed or whether the position is reflected on the firm’s books and records under the U.S. CUSIP, CUSIP International Numbering System (CINS) or foreign symbol. If a foreign-listed security shares an International Securities Identification Number (ISIN) with a U.S.-listed or traded security, a short position in such security should be reported to FINRA using the U.S. symbol and relevant U.S. exchange or trading center (*e.g.*, NASDAQ or over-the-counter).

Q5. Should firms report short interest positions placed in an error account?

- A5. Firms should report as short interest any short positions executed in or placed into an error account that resulted from a “short sale,” as defined by SEC Regulation SHO Rule 200(a), or a transaction that was marked “long,” consistent with SEC Regulation SHO.

Q6. Should a firm report short positions reflected in a dividend reinvestment account that result from the simultaneous purchase of shares for, and credit to, a customer’s account, where the shares are allocated to the customer’s account before the purchase transaction settles?

- A6. A position that resulted from the simultaneous purchase of shares for, and credit to, a customer’s account is not reportable to FINRA—even where the transaction is internally reflected as a short position and remains open until the settlement date of the purchase transaction. Such a short position is not reportable because it neither resulted from a “short sale,” as defined by SEC Regulation SHO Rule 200(a), nor a transaction causing a short position that was marked “long,” consistent with SEC Regulation SHO due to the firm’s or the customer’s net long position at the time of the transaction.

Q7. How should a firm reflect fractional shares in its short-interest reports?

- A7. If a firm has a fractional short-interest position (e.g., 125.6 shares), it should truncate the position to reflect a whole number when reporting such positions to FINRA pursuant to FINRA Rule 4560, instead of rounding the position up or down. For example, firms should report short-interest of 125.6 shares in XYZ as 125 shares.

Q8. Must firms report short-interest positions that result from option exercises or assignments?

- A8. Firms must include in short-interest reports any short positions that result from the exercise or assignment of an option.

Q9. Some prime brokers automatically flip a “long sale” executed at another broker-dealer to a “short sale” (and subsequently report it as short interest) if the customer does not have shares on deposit at the prime broker. Is this permissible under Rule 4560?

- A9. Prime brokers should not automatically assume that such trades are “short sales,” as defined by SEC Regulation SHO Rule 200(a), and must take steps to verify the true nature of the position before reporting it as short interest to FINRA.

Q10. If an exchange is trading a security on a “when-issued” basis where no settlement date has been set, should a firm’s short position in the security be reported to FINRA as short-interest?

- A10. Amended Rule 4560(b) provides that firms must report only those short positions resulting from a “short sale” that has settled or reached settlement date by the close of the FINRA-designated reporting settlement date. Thus, if a transaction has not settled or reached settlement date, or if no settlement date has been established for the transaction, a firm should not report such short position to FINRA as short interest.

Endnotes

1. See Securities Exchange Act Release No. 66872 (April 27, 2012), 77 FR 26340 (May 3, 2012) (Order Approving File No. SR-FINRA-2012-001).
2. Short-interest reports must be received by FINRA no later than the second business day after the FINRA-designated reporting settlement date.
3. The requirement that short-interest reporting be limited to gross short positions was an interpretation previously issued by the Intermarket Surveillance Group (ISG). See Intermarket Surveillance Group, Consolidated Reporting of Short Interest Positions, ISG Regulatory Memorandum 95-01 (March 6, 1995), announcing, among other things, the adoption by the SRO's of policies and procedures that require short-interest position reporting for all securities traded in the United States and the required frequency for reporting short-interest positions to the SROs. Consistent with this longstanding requirement, FINRA and other SROs have brought enforcement actions against member firms for failing to report short positions on a gross basis. See, e.g., *In re Prudential Equity Group, LLC*, AWC No. CLG050038 (April 7, 2005).
4. Rule 200 of SEC Regulation SHO provides that "short sale" means "any sale of a security which the seller does not own or any sale which is consummated by the delivery of a security borrowed by, or for the account of, the seller." See Rule 200(a) of SEC Regulation SHO. See 17 CFR 242.200. SEC Rule 200 further provides, among other things, that a person is deemed to own a security if: (a) the person or his agent has title to it; (b) the person has purchased, or has entered into an unconditional contract, binding on both parties thereto, to purchase it, but has not yet received it; (c) the person owns a security convertible into or exchangeable for it and has tendered such security for conversion or exchange; (d) the person has an option to purchase or acquire it and has exercised such option; (e) the person has rights or warrants to subscribe to it and has exercised such rights or warrants; or (f) the person holds a security futures contract to purchase it and has received notice that the position will be physically settled and is irrevocably bound to receive the underlying security. See Rule 200(b) of SEC Regulation SHO.
5. FINRA, in cooperation with the ISG Short Interest Working Group, determined that the transactions addressed in these three exceptions result in the type of short positions that would be of interest to regulators and the public, and therefore, determined that these exceptions are no longer appropriate.