sifma

September 30, 2021

VIA ELECTRONIC SUBMISSION

Ms. Jennifer Piorko Mitchell
Office of the Corporate Secretary
Financial Industry Regulatory Authority, Inc.
1735 K Street, NW
Washington, DC 20006-1506

Re: SIFMA Comment on Short Interest Position Reporting Enhancements and Other Changes Related to Short Sale Reporting (FINRA Regulatory Notice 21-19)

Dear Ms. Mitchell:

The Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates the opportunity to respond to the request for comment by the Financial Industry Regulatory Authority, Inc. ("FINRA") in connection with FINRA Regulatory Notice 21-19 ("Reg Notice 21-19"), which contemplates changes to the short interest position reporting requirements set forth in Rule 4560 and certain other changes related to reporting information concerning short sales. As set forth in detail below, SIFMA strongly supports FINRA's objectives of ensuring effective regulatory oversight over short sale activity to protect the markets and market participants, and welcomes discussion on potential improvements to disclosure of short sale and short interest reporting regimes. SIFMA is hopeful that its comments provided herein assist FINRA in clarifying the necessity of any improvements to the current regimes, as well as the scope of any such improvements, given other potentially duplicative regulatory initiatives and practical operational concerns imposed upon member firms. In this regard, SIFMA believes that FINRA should expand on its discussion of the goals it would be seeking to achieve through the contemplated initiatives

[1] SIFMA is the leading trade association for broker-dealers, investment banks, and asset managers operating in the U.S. and global capital markets. On behalf of our industry's nearly one million employees, we advocate for legislation, regulation, and business policy affecting retail and institutional investors, equity and fixed income markets, and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. With offices in New York and Washington, D.C., SIFMA is the U.S. regional member of the Global Financial Markets Association (GFMA).

and identify how any proposed rule changes would further such goals in a workable manner. An increased level of specificity will enable firms to more precisely evaluate the ramifications of any such proposals and provide the most constructive feedback possible, which will help ensure the costs are commensurate with the benefits. In this regard, SIFMA firms believe that FINRA needs to engage in a much more fulsome analysis of the potential economic impacts of the potential initiatives than that set forth in Reg Notice 21-19. SIFMA firms strongly encourage FINRA to engage with them in a further dialogue prior to the inception of any rulemaking proposals.

I. Executive Summary

As has been widely recognized by FINRA and the U.S. Securities and Exchange Commission ("SEC" or "Commission"), short selling is a longstanding, legitimate practice that provides numerous benefits to the market, including market liquidity and pricing efficiency.[2] At the same time, recognizing the potential for abuses, the SEC has adopted comprehensive short sale regulations, including Regulation SHO ("Reg SHO"), which applies a prophylactic rule set and is subject to robust examination and enforcement by both the SEC and FINRA. As set forth in greater detail below, there currently is also significant transparency of short sale and short position information that may be leveraged by FINRA and consolidated into a publicly-disseminated report, if deemed by FINRA to be helpful. Moreover, in addition to FINRA's potential enhancements to such reporting regimes, there are similar disclosure initiatives related to short selling and securities lending on which the SEC is contemplating taking action. SIFMA strongly believes that there needs to be harmonization of these different regulatory initiatives to avoid duplication, as well as careful consideration of the goals sought to be achieved as balanced against the potentially significant costs to SIFMA member firms and other market participants.

SIFMA commends FINRA on its thoughtful consideration of potential enhancements to short sale and short position disclosure as set forth in Reg Notice 21-19. SIFMA supports the inclusion of certain additional information in FINRA-disseminated short interest data (*e.g.*, both Exchange-Listed and OTC Equity Securities, Total Shares Outstanding and Public Float information, and Threshold Security Identification), however, as explained further in this letter, SIFMA believes that FINRA should include alongside the data certain accompanying disclosures that are intended to avoid confusion and/or mis-interpretation of the data.

In addition, while achieving consensus among all SIFMA firms is difficult, many firms could be amenable to FINRA publishing total short interest that is segregated into two categories—short interest held in proprietary accounts and short interest held in customer accounts. However, in deciding whether to propose rule amendments to require this information: (i) FINRA should provide further explanation of how this information supports the policy initiatives of short interest reporting; and (ii) when reporting such information, FINRA should, again, provide certain clarifications to

[2] Securities Exchange Act Release No. 61595 (Feb. 26, 2010), 75 FR 11232 (Mar. 10, 2010).

avoid confusion and/or mis-interpretation of the data by the public (*e.g.*, many "firm" positions may actually be established in connection with facilitating customer transactions).

However, SIFMA firms strongly oppose the reporting, even just to FINRA, of short positions in individual accounts for all the reasons set forth in detail below, including the significant cyber security risks and inadvertent data breach risks associated with disseminating voluminous customer-specific sensitive confidential information that may reveal proprietary trading strategies as well as the possibility of data quality issues given the number of accounts and positions that would need to included.

SIFMA firms are also strongly opposed to the reporting of synthetic short positions, given potential overlap or conflict with other regulatory initiatives on security-based swap reporting and the potential for creating a misleading impression of the overall short interest due to the exclusion of a significant percentage of synthetic short positions being entered into with financial institutions that are not FINRA members.

Certain contemplated changes will be very burdensome for SIFMA firms, and thus SIFMA urges careful consideration by FINRA of the expected benefits and rationale for these changes. Chief among these concerns is the considered change to require firms to submit short interest reports on a weekly, or even daily basis. As set forth in detail below, firms and their service providers expend a significant amount of time complying with the current requirement to report short interest twice per month. Furthermore, under the current reporting regime, as it is practiced today, after SIFMA firms have submitted their short interest reports, FINRA will send firms questionnaires that ask firms to reconfirm dozens of reported short positions and provide explanations as to the underlying transactions with respect to a subset of these positions. This ongoing practice has the effect of requiring firms to internally vet, reach out to internal trading desks, and prepare written explanations over a period of three business days past the reporting submission deadline and, at times, this may expand to additional days upon further questioning by FINRA (and often beyond and into the next reporting cycle). Thus, daily reporting of short positions under the current structure of Rule 4560 would be virtually impossible, and weekly reporting would be extremely challenging if this current process were to continue.

If FINRA seeks to increase the frequency of short interest reporting, then in order to make it practical to implement (and without the regulatory reporting teams at firms having to work on more than one short interest report submission simultaneously—which can lead to confusion and inaccuracies), SIFMA firms feel strongly that it should be based on the reporting of all gross short positions on a firm's books and records, subject to certain exceptions discussed below, while also: (1) eliminating the requirement for firms to further scrutinize their stock records to ensure there is only reporting of short positions that resulted from a "short sale," as that term is defined in Rule 200 of Reg SHO, as well as where the sale transaction that caused the short position was marked "long," consistent with Reg SHO, due to the firm's or the customer's net long position at the time of the transaction (*e.g.,* aggregation units), and to exclude short positions resulting from sales of securities

that a person is "deemed to own"; and (2) FINRA changing its current practice of regularly requiring firms to review and explain underlying transactions with respect to previously submitted short interest reports.

Firms should also be granted a reasonable opportunity to cure any defects that may occur under any such substantially heightened reporting obligation and should generally not be penalized for these defects, so long as they implement and routinely employ reasonable processes and procedures in accordance with FINRA's requirements. The member firms believe this approach strikes a reasonable compromise between FINRA's regulatory interests and the operational challenges that increased reporting requirements would create for firms, as discussed throughout this letter.

In its prior comment letter in 2012 concerning FINRA's most recent proposed changes to short interest reporting, SIFMA advocated for basing short interest reporting on the positions that appear on firms' stock records without also tying such reporting to the marking of orders (*i.e.*, as "short," "long," or "short exempt") that contributed to such short positions.

In this regard, certain of the contemplated changes referenced in Reg Notice 21-19 would require firms to pull in for reporting to FINRA information that *does not* appear on their stock record in the ordinary course. This would include, but is not limited to, synthetic short positions and information on allocations of fail-to-deliver positions under Rule 204(d) of Reg SHO. Requiring firms to collect this information from other parts of their systems and books and records would be very burdensome and increase the potential for errors in reporting. SIFMA, therefore, strongly urges FINRA to consider the goals and benefits associated with these contemplated changes, especially in light of the information that is currently available to FINRA and other proposed regulatory initiatives. Moreover, if FINRA does determine that this additional information is warranted, there would need to be much greater clarity on the delineations of specific requirements and substantive definitions of terms underlying such requirements.

II. Leverage Current Regulatory Regime for Reporting of Short Sales and Short Positions

In Reg Notice 21-19, FINRA states that the rationale behind the potential short sale-related reporting enhancements would be to provide greater transparency on short sale activity that "can be of use to market participants who consider short interest when evaluating investment opportunities," and also to "allow FINRA to monitor for compliance more efficiently with Regulation SHO and other short sale obligations." While SIFMA supports FINRA's goals, it encourages FINRA to consider further how currently available short sale and short position information required under the current regulatory/reporting framework could help to attain these objectives.

a. Trade Reporting

Upon the execution of an order, a report of the transaction is submitted to an exchange (if executed on the exchange) or to FINRA (if executed over-the-counter), which includes the identification of whether the order was a short or long sale, or a short exempt sale. Such trade reports are generally

required to be submitted shortly after execution of the order (*e.g.*, to FINRA within 10 seconds of execution).

b. Daily Aggregate Reporting

There is also current public reporting of aggregate short sales by issuer. Specifically, based on the trade report information received from brokers in connection with short sales, the exchanges and FINRA publish on their websites information on aggregated short sale volume by security. FINRA, in particular, publishes on its website a Daily Short Sale Volume File, which provides aggregate daily short sale volume data by security for most U.S. stocks traded over-the-counter. FINRA further publishes a Monthly Short Sale Transaction File, which provides public access to more specific transaction data for generally every over-the-counter short sale transaction in U.S. exchange-traded stocks. Moreover, the various exchanges also publish for a cost short sale files based on the trading activity on each respective exchange. SIFMA raises, for FINRA's consideration, the possibility that this information could be presented alongside the current reporting of short interest positions (*e.g.*, for the mid-month short interest report, include the average daily aggregate short sale volume from the 1st to the 15th day of the month), if FINRA concludes that doing so would provide market participants with a more complete picture of the overall short activity and short positions in any given security and achieve certain objectives set forth in Reg Notice 21-19.

c. Consolidated Audit Trail ("CAT") Reporting

Any broker-dealer that is a member of a national securities exchange or FINRA and receives, originates and/or handles orders in NMS Securities, which includes NMS stocks and Listed Options, and/or OTC Equity Securities, must report such information to CAT. CAT is designed to capture the end-to-end lifecycle of a trade, including but not limited to, quotes, original receipts or originations of an order, modifications, cancellations, routing, receipts of a routed order execution (in whole or in part) and, ultimately, order allocations. SIFMA notes that in Reg Notice 21-19, at footnote 21, FINRA indicated that "the data collected from firms through short interest reporting is distinct from, and cannot be derived from, the information available through the Consolidated Audit Trail (CAT)." SIFMA recommends that FINRA analyze further whether the information available through CAT can be used in achieving the regulatory objectives.

d. Short Interest Reporting

As FINRA notes in Reg Notice 21-19, there is currently public reporting of short interest under FINRA rules. Specifically, Rule 4560 currently requires member firms to maintain and report, on a twice-monthly basis, records of aggregate short positions that a firm holds in all customer and firm accounts.

Under Rule 4560, in general, each member is required to maintain a record of total "short" positions in all customer and proprietary firm accounts in all equity securities (other than Restricted Equity

Securities, as defined in Rule 6420)[3] and is required to report such information to FINRA twice per month.

The current Rule provides that members must report all gross short positions existing in each firm or customer account, including the account of a broker-dealer, that resulted from a "short sale," as that term is defined in Rule 200 of Reg SHO, as well as where the sale transaction that caused the short position was marked "long," consistent with Reg SHO, due to the firm's or the customer's net long position at the time of the transaction (*e.g.,* aggregation units), and to exclude those short positions that resulted from sales of "deemed-to-own" securities. As SIFMA had indicated in a prior comment letter,[4] FINRA members generally report short positions based on the gross short positions on their stock records without the practical ability to determine whether such gross positions arose from out of scope transactions, such as corporate actions, transfers in of shorts positions that were held by the client at another broker, ETF creations, or sales of deemed to own securities that have not yet been received by the reporting firm. SIFMA reiterates it concerns with the ability to comply with the current rule as written and proposes that Rule 4560 be revised to require firms to report gross settled short positions on its books without regard to the nature of the transaction that caused the establishment of such position.

Because of this practical inability, FINRA regularly asks firms to respond within three business days after they have submitted their short interest reports to verify the accuracy of the reported quantities for an extensive list of securities, provide copies of the firm's stock records, and confirm that the reported shares quantities are adjusted for stock splits, reverse splits or stock dividends. This requires firms to engage in a significant post-reporting reconciliation process.

SIFMA recognizes that FINRA is seeking to enhance its short interest reporting requirements through Reg Notice 21-19. As described in more detail below, SIFMA recommends that FINRA work to streamline existing short interest reporting requirements in connection with any enhancements of its short interest reporting regime. Moreover, SIFMA notes that such streamlining is absolutely necessary before any move to shorten the short interest reporting regime from the current bimonthly requirement can be contemplated.

e. Large Options Position Reporting ("LOPR")

With respect to FINRA's consideration of including synthetic short interest positions as part of enhanced short interest reporting, FINRA Rules already require disclosure of significant options positions of members and their customers. Specifically, FINRA Rule 2360(b)(5) requires, among other things, that each member prepare a report with respect to its own accounts, those of its employees, officers, and directors, as well as its broker-dealer and non-broker-dealer customers,

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[3] FINRA Rule 6420(k) defines the term "Restricted Equity Security" to mean "any equity security that meets the definition of 'restricted security' as contained in Securities Act Rule 144(a)(3)." *See* 17 C.F.R. § 230.144.

[4] *See* (https://www.sifma.org/wp-content/uploads/2017/05/sifma-submits-comments-to-the-sec-on-amending-finra-short-interest-reporting-rule.pdf).

which, acting alone or in concert, has an aggregate position of 200 or more options contracts (whether long or short) of the put class and the call class on the same side of the market covering the same underlying security or index. These LOPR requirements generally cover both standardized options and conventional options.[5] The LOPR requirements already impose significant reporting burdens on FINRA members that would be duplicated if FINRA were to create additional synthetic short interest reporting. FINRA has not offered any explanation as to why existing LOPR cannot be used to fulfill FINRA's objectives.

f. Swap Reporting

The CFTC has a reporting regime concerning swaps, and the SEC is imposing security-based swap reporting requirements. As noted, SIFMA believes it is important for FINRA to consider these swap reporting requirements to avoid duplication of requirements for member firms and/or the presentation of misleading information to the market.

III. Publication of Short Interest for Exchange-listed Equity Securities

FINRA has stated in Reg Notice 21-19 that it is considering the publication of short interest data that is reported to FINRA for both listed and unlisted securities. Thus, short interest files for all equity securities would be made available, free of charge, on the FINRA website and would not require changes to firms' reporting requirements. SIFMA supports this change, assuming this data is made available entirely free of charge and in a readily accessible file format, such that all market participants may freely access (and manage to utilize) it through FINRA's website, and further recommends that FINRA also consider incorporating into the short interest files published twice per month the additional information on short sales and short positions that is currently available to FINRA (*e.g.*, the mid-month short interest report could include an average of the aggregate daily short sale data, from the beginning of the month to mid-month), as set forth above.

IV. Content of Short Interest Data

The substantive information that would be collected under the contemplated regulatory changes is delineated within Reg Notice 21-19 between several categories, certain of which are seamless, and others of which would present distinct and considerable challenges for market participants. Thus, these are each addressed in turn.

a. TSO and Public Float

FINRA is considering including in FINRA-disseminated short interest data, where available, the total shares outstanding ("TSO") and public float for securities. SIFMA does not object to the

[5] With respect to standardized options, LOPR is only required to the extent the FINRA member is not a member of the options exchange on which the option is listed and traded. To the extent that this leads to a gap in FINRA's information with respect to large synthetic short positions in standardized options, FINRA could obtain this information from the relevant options exchange.

inclusion of this information, however, it believes that FINRA should provide, as part of the dissemination of the twice-monthly report, clarifications on this information to avoid mis-interpretations. Specifically, in the ordinary course, the amount of short interest may indeed near or exceed an issuer's total shares outstanding, even though such short sale activity may be completely compliant with Reg SHO and other short sale regulations. Take the following example:

- Company issues 100 shares of stock.
- Holder A purchases such 100 shares of stock.
- Holder A lends 75 shares of stock to Short Seller 1, who sells to Holder B (Holder B has a securities entitlement to such 75 shares, and indeed will generally be unaware that they are even purchasing borrowed stock from a short seller).
- Holder B, in turn, lends 50 shares of stock to Short Seller 2, who sells to Holder C.
- If Short Seller 1 and Short Seller 2 both maintain settled short positions as of the short interest reporting date, the short interest for Company will reflect 150 shares, while the TSO for Company will only be 125 shares.[6]

Such short selling activity, whereby Short Sellers are obtaining "locates" prior to effecting short sales and shares are indeed borrowed for delivery, is in compliance with Reg SHO. Moreover, such activity, involving loans of long positions, occurs through the normal functioning of the markets, provides liquidity to those markets, and is not indicative of any manipulative activity. Thus, SIFMA believes that FINRA should include disclosure, as part of the public dissemination of short interest, describing the mechanics of short sale transactions and how this can naturally lead to aggregate short interest near or exceeding the TSO, to avoid potential mis-impressions by the public. Separately, we encourage FINRA to take steps to educate the public and correct the specific prevalent misperception that when short interest is high in relation to the float, it constitutes evidence of naked shorting abuse.

b. Threshold List Field

FINRA is considering including in FINRA-disseminated short interest data a new field that would indicate if the security is a Reg SHO Threshold Security as of the short interest position reporting settlement date. This change would not alter firms' reporting requirements. SIFMA does not object to the inclusion of this field as part of the twice-monthly short interest report, as well as, again, incorporating into the short interest files published twice per month the additional information on short sales and short positions that are currently available to FINRA. Similar to the clarifications on

[6] In the same vein, the total long position in stock beneficially owned across Holder A, Holder B, and Holder C will be 225 shares, while the TSO for Company will only be 100 shares. Please note that, as has been described by the SEC, this occurs due to the normal functioning of the securities markets, and is not indicative of abusive activity or the creation of "phantom shares." *See* https://www.sec.gov/litigation/briefs/nanopiercesecbrief.pdf

the TSO information, however, SIFMA believes that FINRA should include clarifications concerning the nature of Threshold Securities to accompany the public disclosure—in this regard, SIFMA notes public statements by the SEC recognizing that not all Threshold Securities are indicative of a "problem" concerning such security and/or manipulation or non-compliance with short sale regulations.[7]

c. Proprietary and Customer Account Categorization

The contemplated modifications to FINRA's short interest reporting requirements under Rule 4560, which currently requires the reporting of gross short interest positions held across all accounts on an aggregated basis, would also require firms to report short interest positions categorized by two types of accounts as of the close of the designated reporting settlement date—those held in "proprietary accounts" and those held in "customer accounts." This could require some firms to implement significant changes to current short interest reporting systems to accommodate such new categorization requirements. While member firms do generally maintain such information internally and may potentially provide it to FINRA, requiring this more detailed information (*i.e.*, beyond just the current reporting of total gross short position in each security) could lead to errors in reporting.

SIFMA believes that, in connection with any proposed rulemaking related to such contemplated changes, FINRA should set forth in greater detail the objectives that would be achieved through requiring this information. Firms subject to the Volcker Rule may not take "proprietary" positions, and any short positions existing in "principal" accounts would generally be in connection with facilitating customer transactions. Thus, it is questionable what differentiating such account information would seek to achieve, and could lead to mis-interpretation by other market participants to the extent that there is public dissemination (*i.e.*, positions existing in firm accounts could be mistakenly believed to be in connection with speculative proprietary positions). SIFMA strongly believes that, if FINRA does determine in the course of any proposed rulemaking that separating "principal" versus "customer" accounts as part of short interest reporting is beneficial information for market participants (which, again, SIFMA does not believe has yet persuasively argued), such determinations of "principal" versus "customer" should be based solely on the classifications of accounts in firms' stock records.

Separately, SIFMA members are opposed to reporting short interest separately for retail and institutional clients because of the potential for misleading information, and implementation challenges.

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[7] *See, e.g.*, Question 5, SEC. & EXCH. COMM'N, KEY POINTS ABOUT REGULATION SHO (2015), accessible at: https://www.sec.gov/investor/pubs/regsho.htm ("The appearance of a security on a threshold list does not necessarily mean that there has been abusive "naked" short selling or any impermissible trading in the stock. Delivery failures can be caused by both long and short sales. In addition, notwithstanding actions by broker-dealers to close out delivery failures, certain securities may remain on an SRO's threshold securities list for a variety of legitimate reasons . . . .").

d. Account-level Position Information

FINRA is also considering modifying Rule 4560 to require even greater specificity, such that firms would be required to report to FINRA all short interest positions held in any account at the individual account level, as well as methods for subsequently identifying the individual account holders of the short interest positions reported by each firm on an account-level basis. SIFMA member firms uniformly strongly believe that the demonstrated need for such voluminous and highly sensitive information to achieve a regulatory objective has not been sufficiently articulated to justify the apparent associated risks and significant costs of implementation.

Short positions are considered by many clients to be among the most sensitive and confidential information that firms maintain on their behalf. Chief among the risks of providing such information are the cyber security, theft and inadvertent data breach concerns associated with the dissemination of a substantial amount of highly sensitive client account information that may reveal commercially sensitive proprietary strategies to FINRA on a regular basis. While, of course, FINRA has the ability to request such information from firms, under the current framework such requests are appropriately narrowly-tailored to situations where FINRA may have specific concerns on particular trading activity.

Requiring firms to download such information in the ordinary course, on at least a twice-monthly basis and perhaps more frequently, raises substantial data quality concerns in reporting given the granularity of the information requested and how common it is for specific allocations to underlying beneficial owner accounts to be corrected after settlement date. Member firms uniformly share the concern that the mere transmission of the sizeable data sets required for producing specific account-level information may become technically unreliable at best, and wholly unmanageable at worst.

While FINRA has specifically indicated in Reg Notice 21-19 that it does not intend to publicly disseminate this information, the above concerns (and in particular about security concerns) nonetheless apply to the transmission of such data by firms to FINRA.

e. Synthetic Short Position

FINRA discusses potentially requiring clearing firms to report synthetic short exposure (*e.g.*, sales of calls and purchases of puts) in firm and customer accounts in short interest reports. SIFMA members strongly oppose the reporting of synthetic short positions given other potentially conflicting or overlapping regulatory initiatives, and the potential to create a misleading picture of short interest given (a) the potentially wide variety of forms of synthetic transactions that could fall outside of the scope of the positions required to be captured for reporting, and (b) the significant material quantity of synthetic short positions entered into with financial institutions other than FINRA members that would not be captured for reporting. SIFMA urges a cautious approach in this area, given the risks that defining synthetic short positions (i) too broadly in the hopes of being comprehensive could create ambiguities that lead to inconsistent interpretation and implementation

by firms, and (ii) too narrowly could be misleading by its material omissions and have unintended consequences of market participants moving to a different form of synthetic short position falling outside of the scope of the rule.

In order to accurately assess all of the potential impacts and obligations resulting from these changes, SIFMA members believe that FINRA should articulate a clear definition of which synthetic short positions would be covered. There are a variety of swaps and options transactions, taken individually or in specific combinations of positions held by clients across more than one FINRA member or other counterparty, that could create a synthetic short position, and such clarity would be a prerequisite to creating processes to systematically capture and report such information.

Even if such processes were able to be created, SIFMA questions the utility of reporting related to synthetic short positions. For instance, it is not uncommon for synthetic short positions to be held outside of the FINRA member broker dealer, including at foreign entities that are not FINRA members, or to be established across multiple FINRA members. Moreover, given the dynamics of customers potentially using multiple firms, it would be unreasonable for FINRA to place members in the position of having to conduct any diligence regarding customer synthetic short position beyond their own books and records. Thus, requiring FINRA members to report synthetic short positions could provide misrepresentations concerning the total such short positions in a security (*i.e.*, would not include positions held at non-FINRA members) and/or even drive such activity further away from FINRA members.

It is also the case that the counterparty to a derivative transaction that provides short exposure to the customer, who would have the offsetting synthetic long exposure, will also often hold a cash short position to hedge such exposure. Thus, inclusion of the synthetic short position in reporting could create a misleading impression to market participants, in that it could overstate the amount of short interest in a particular security (*i.e.*, "double count" in short interest the synthetic short position and the counterparty's hedge).

Clearing firms and prime brokers would need to engage in significant programming efforts to capture in their short interest reporting information related to synthetic short positions that is not currently collected. This would require identifying, developing, integrating, and testing new systems and would also require firms to change their reporting logic to include any additional products that may become necessary, which itself would depend entirely on the provision of clearly defined terms with respect to synthetic short positions, as described above. Member firms collectively noted that it would take multiple individuals and hundreds of person-hours to implement a programmatic change to include synthetic short positions. For example, with respect to reporting a sale of a call option and purchase of a put option where the options have the same strike price and expiration month, multiple firms estimated that it could take approximately up to six months to build and test new systems.

Moreover, and likely as a threshold matter, FINRA should take steps to ensure that there is not duplicate and/or inconsistent reporting of such synthetic short position information. In addition to security-based swap reporting requirements, the SEC has announced that it is considering whether to require market participants (*e.g.*, institutional investment managers required to report on 13F) to disclose short positions directly to the SEC. Also, long put positions are currently required to be included on 13Fs filed by institutional investment managers. Accordingly, FINRA should not impose amendments to require the inclusion of synthetic short position information as part of short interest reporting until the SEC has had the opportunity to consider whether such additional short disclosures are warranted and appropriate.

f. Loan Obligations Resulting from Arranged Financing

FINRA proposes requiring clearing firms to report loan obligations resulting from arranged financing and enhanced lending programs. Members would be required to report as short interest outstanding stock borrows by customers in their arranged financing programs to better reflect actual short sentiment in the stock.

With respect to such arranged financing/enhanced lending models at member firms, certain ones may involve the loan of shares to customers from domestic affiliates and others may involve the loan shares to customers from foreign affiliates. Thus, SIFMA believes that FINRA should consider such different models and the availability of such information to FINRA member firms, before proceeding to require such information. In addition, clearing firms and prime brokers would likely need to engage in significant programming efforts to capture loans due to arranged financing in their short interest reporting. In any event, SIFMA members believe that any rule proposal should either require them to report solely based on what they have captured in their own books and records, or should take into account challenges in sourcing information from an affiliate subject to its own regulatory framework.

With respect to the amount of time necessary to build, test, and implement new systems to comply with the proposed requirement, firms estimated it would take between several months and one year.

V. Frequency and Timing of Short Interest Position Reporting and Data Dissemination

FINRA seeks comment on the frequency and timing of short interest position reporting. Specifically, FINRA is considering requiring FINRA members to submit short interest reports weekly or daily.

SIFMA firms strongly believe that daily reporting would be extremely challenging, if even possible, to implement while still meeting minimally acceptable data quality and reliability standards for public dissemination, and that a weekly reporting requirement may only be feasible if the information being collected is sufficiently and narrowly defined such that firms could readily and precisely establish what specific information they are required to provide. In order to make increased frequency a practicable, implemental option for firms, SIFMA believes the reporting

requirements and related follow-up processes by FINRA of requiring firms to review and explain underlying transactions with respect to previously submitted short interest reports must be simplified and streamlined, *i.e.*, firms should only be required to report gross short positions from accounts on their stock records that generally hold reportable short positions (*e.g.*, "short accounts" and other margin accounts) without requiring further analysis concerning whether the short position resulted from a "short sale" or a "deemed to own sale." As SIFMA previously noted in its comment letter from 2012, requiring such further analysis is incredibly difficult under the current twice-monthly reporting regime, and will be even more challenging under more expedited filing schedules.

More specifically, considering the large number of transactions that may contribute to these short positions, it is extremely difficult, if not impossible, for clearing brokers to determine manually whether positions should be excluded based upon information that is not contained in the stock record. Indeed, in certain situations, it may be difficult for a firm to determine whether a short position resulted from a sale at all. Examples of such situations include the following:

a. Options Exercises and Assignments

With respect to options exercises and assignments, the exercise or assignment of an option is generally not marked as either "long," "short," or "short exempt." This being the case, if the exercise or assignment results in a firm having a short position, such a short position will generally be included as part of the gross short positions reported to FINRA. This would seem to be consistent with the policy goals of the Rule, as the holder of the option position is, in fact, economically short in the same manner as where a short sale had been effected in the open market. Based on current FINRA guidance, firms include in short interest reporting short positions resulting from options exercise/assignment.

b. Internal Transfers

Firms often use internal matching systems that compare orders before sending them externally for execution. Thus, in a simple example, if an order to buy 100 shares of XYZ and an order to sell 100 shares of XYZ were submitted simultaneously, a firm's internal processes and systems could match the buy and sell orders. In certain situations, a short position can result from an internal transfer from one broker-dealer's account to another account of that same broker-dealer in connection with an internal match. Given the automated systems employed by firms and the time restrictions of short interest reporting, it would be extremely difficult for firms to determine that a short position resulted from an internal transfer/journal and to remove that position from the firm's short interest report. This information is not contained in the stock record and is not accessible. Again, it would also be consistent with the Rule's policy goals to include such short positions in short reporting, as the account would have economic exposure in the same way as a short sale effected in the open market. Firms currently include such short positions in their short interest reporting.

c. Exchange Traded Funds

In connection with the creation of an ETF, an "authorized participant" delivers a basket of securities to the fund's agent bank. In certain situations, the authorized participant may deliver borrowed securities, thus resulting in a short position on the firm's books and records. The firm may also sell short securities in the same account in which the ETF is created in order to rebalance the portfolio to accurately reflect the ETF. Standard brokerage accounting systems are not able to distinguish the firm "short" positions resulting from delivery for creation versus the short positions held in connection with rebalancing. Because, for at least certain firms, the "short" positions due to borrowing in connection with ETF creations cannot be differentiated systematically from other short positions using standard brokerage accounting systems, and because both types of positions have the same economic effect with respect to the borrowing firm and the marketplace, SIFMA believes that these short positions should be included in firms' short interest reporting.

d. Deemed to Own Securities

SIFMA believes that it is extremely challenging for firms to comply with the current exception from short interest reporting for short positions resulting from the sale of securities that the seller is "deemed to own" under Reg SHO. In certain situations, clearing brokers may not have access to information about the actual execution, including whether the short position resulted from a sale of an "owned" security. In these situations, it would be extremely difficult, if not impossible, for clearing brokers to obtain such information and to then exclude such positions from the short interest report.

The current version of the Rule requires firms to record and report short positions held in each individual firm or customer account on a "gross," as opposed to a "net," basis, including accounts of a broker-dealer: (1) that resulted from a "short sale," as that term is defined in Rule 200(a) of SEC Reg SHO; or (2) where the transaction(s) that caused the short position was marked "long," consistent with SEC Reg SHO, due to the firm's or the customer's net long position at the time of the transaction (*e.g.*, aggregation units).

While, again, SIFMA recommends adjusting short interest reporting to only require member firms to report gross short positions held in accounts on their stock record that will usually hold reportable short positions, to the extent FINRA maintains the exclusion for "deemed to own" short positions, SIFMA recommends revising this requirement to only cover those situations where the broker-dealer is relying on the exception provided in Rule 204(a)(2) of Reg SHO for sales of a security that a person is deemed to own and will deliver as soon as all restrictions on delivery have been removed, subject to this exception only applying to the amount of shares for which the exception provided in Rule 204(a)(2) is claimed.

Under our proposed approach, if a short position resulted from any of these situations, the short position would not be included in short interest reporting. Moreover, and as discussed, firms would

have a reasonable opportunity to cure any defects that FINRA may identify in this process and would not be penalized for such defects, so long as they employ reasonable policies and procedures for governing their internal reporting protocols in accordance with FINRA's requirements. SIFMA believes that revising the exception in such manner would serve the policy goals of short interest reporting and would allow firms to more efficiently and accurately report short interest.

In addition, our proposed approach would address those situations where a broker-dealer is clearing for other broker-dealers who act as market makers or proprietary traders, where there generally will not be separate cash and margin accounts maintained, which would otherwise allow the clearing broker to be able to identify positions that should be excluded from short interest reporting.

VI. Information on Allocations of Fail-to-Deliver Positions

FINRA proposes requiring clearing firms to report daily allocations of fail-to-deliver positions under Rule 204(d) of Reg SHO for OTC equity and exchange-listed securities. The Notice outlines the following categories as proposed fields for the report: (i) security; (ii) identity of correspondent firm; (iii) amount allocated to correspondent firm (number of shares); (iv) trade date(s); (v) allocation date; (vi) closeout date; and (vii) applicable closeout obligation (T+3, T+5, or T+35). Many clearing firms that do allocate fail-to-deliver positions to those broker-dealers for whom they clear utilize automated systems that track trade activity and short positions of clients, and then systemically generate Rule 204(d) fail-to-deliver notices to broker-dealer clients, as applicable, for this specific purpose. Requiring firms to extract such fail-to-deliver notices from their regular systems and produce them in a separate format to FINRA would involve substantial costs.

Firms also noted that, beyond the costs and burdens associated with implementing systems capable of generating such reports accurately and on a consistent basis, reporting such information would involve unprecedently large volumes of data and thus raise the substantial possibility for errors in reporting. Many SIFMA member firms either currently, or would be forced to, utilize a third-party vendor for establishing systems capable of generating such voluminous reports, even if not required on a daily basis. Moreover, one such third-party vendor noted the dramatic increase in the potential for failures during transmission and other technology related issues associated with transmitting such information to FINRA.

SIFMA firms strongly believe that FINRA must consider the dramatic internal costs and operational challenges that the Proposed Daily Allocation Report would create when balanced against FINRA's existing ability to, and long-standing experience with, obtaining such information directly from clearing firms under the current reporting process. When coupled with SIFMA members being unaware of material obstacles that have frustrated FINRA's efforts in obtaining this information from clearing firms under the current regulatory framework, as well as some firms reporting that FINRA generally requests such information as little as four times a year or less, SIFMA strongly urges FINRA to maintain its existing (and what they believe to be efficient) process of direct

outreach to clearing firms, on a more targeted as-needed basis, for obtaining this highly discrete information.

Moreover, should FINRA proceed with the Proposed Daily Allocation Report, firms may, in theory, ultimately manage to undergo the substantial operational changes and significant programmatic coding efforts necessary to providing many of the data fields enumerated in the proposal. However, clearing firms would continue to lack the information necessary to providing FINRA with the applicable close-out obligation time periods imposed on correspondent firms, information which will remain in the possession of the introducing firms, is not made available to clearing firms, and therefore cannot be provided to FINRA, irrespective of any modifications to existing reporting requirements. Stated another way, in situations where a clearing firm allocates fails to deliver to broker-dealers for which it clears, the allocated broker-dealer (and not the clearing firm) bears the responsibility to determine the appropriate close-out timeframe, including whether it can rely on the extended close-out timeframes for fails to deliver due to bona-fide market making sales, long sales, and deemed to own sales.

VII. Other Short-Sale Related Initiatives

FINRA proposes requiring firms to report to FINRA (for regulatory purposes, but with an eye toward eventual public dissemination) certain information on stock loans. FINRA requests comment on whether FINRA should explore creating a reporting framework around stock lending activity. For example, member firms that engage in stock lending transactions could be required to report loan terms to FINRA, such as the rebate rate (for new loans, open daily loans, and re-rates), loan amount, and contra-party information.

Fundamentally, SIFMA member firms lack any indication as to the specific and beneficial value that the receipt of such voluminous detailed information would provide to FINRA in furtherance of achieving its regulatory objectives, which would be important to better understand in light of the significant programming efforts that firms would need to engage in to compile and report loan terms, loan amount, and contra-party information to FINRA on a periodic basis. Therefore, in the absence of a clearly articulated regulatory oversight benefit that would justify such an extensive new and burdensome reporting regime, SIFMA member firms strongly oppose this proposal. Furthermore, in that these are one-off negotiated bilateral stock lending transactions between parties, SIFMA firms fail to appreciate any material benefit of this information.

Separately, the SEC has indicated that it plans to engage in rulemaking to further implement Section 984(b) of the Dodd-Frank Act, which allows the Commission to 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. So, again, SIFMA strongly encourages FINRA to take steps to avoid duplicative requirements being imposed upon firms, particularly given the existence of data providers who currently provide some of this information (in an aggregated and anonymized form), as discussed above. Moreover, any movement in this direction should take into account lending

platforms and other providers that provide certain transparency regarding securities lending transactions.

VIII. Implementation Difficulties and Costs

In order to fully understand and assess the implementation difficulties and costs of the contemplated short sales and short positions reporting regime changes in Reg Notice 21-19, SIFMA believes that FINRA would need to provide further clarity and detail on such regime changes, as further discussed below. Nevertheless, even without such detail, SIFMA believes that requiring changes to the existing reporting requirements or timing of the reporting will pose significant challenges and be costly for firms and other market participants to implement.

FINRA Rule 4560 requires firms to produce information on a twice-monthly basis, which in itself proved to be extremely onerous. Several firms indicated that complying with Rule 4560 necessitated the engagement of an outside vendor to facilitate this process.

In order to comply with the contemplated adjustments to the reporting requirements of Rule 4560, systems for collecting the reportable information would have to be established and/or updated, requiring significant infrastructure changes and substantial development efforts impacting many different departments and systems at substantial costs. At this time, it is virtually impossible to estimate the costs that such reporting would require without, as discussed below, understanding in more detail some of the more specific requirements of the contemplated changes, including knowing how the terms "proprietary accounts" or "synthetic short positions," as used in the FINRA Reg Notice 21-19, would be defined.

SIFMA recommends that, in connection any changes to the short sales and short positions reporting regime, FINRA consider these costs and challenges against any expected benefits of such reporting requirements.

IX. Harmful Unintended Consequences of Contemplated Changes

The additional information sought and expedited timeframe for public dissemination of such information would create a number of practical difficulties that could have harmful consequences for investors, issuers, broker-dealers, and the marketplace as a whole.

Specifically, firms could be required, directly or indirectly, to disclose the trading strategies of their customers, themselves the very market participants such measures would seek to protect, and which could compromise the ability of those participants to manage their market risk exposure. This raises concerns that other market participants may use such information to their own benefit and to the detriment of firms' customers, and the investing public.

This may result in investors losing confidence in the equities markets and becoming less inclined to effect short sales, which could drain liquidity from the market (on both the long and short side) and

otherwise deprive investors, and the market overall, of the numerous benefits provided by short sellers.

* * *

We appreciate your consideration of our comments and look forward to engaging with FINRA further on subsequent developments concerning changes to short interest position reporting and short sale rules. Please feel free to contact the undersigned at 202-962-7300 on this matter with any questions.

Respectfully submitted,

Robert Toomey
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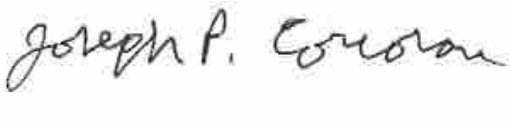
Securities Industry and Financial Markets Association



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