



September 30, 2021

By email to: pubcom@finra.org

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

RE: Regulatory Notice 21-19: Short Sales

Dear Ms. Mitchell:

I am writing on behalf of the North American Securities Administrators Association, Inc. (“NASAA”)¹ in response to Financial Industry Regulatory Authority (“FINRA”) Regulatory Notice 21-19: *Short Sales* (the “Proposal”).² The Proposal outlines several potential changes to FINRA’s short sale reporting program, including potential expansions of FINRA Rule 4560, *Short-Interest Reporting*, and a potential new FINRA rule regarding failures-to-deliver. NASAA broadly supports the Proposal and encourages FINRA to continue developing it with the goal of presenting actionable rule proposals to the Securities and Exchange Commission (“SEC”).

I. FINRA Should Mandate Daily Short-Interest Reporting at the Account Level.

NASAA supports FINRA’s proposed changes to short interest reporting, with certain revisions. First, we agree with the Proposal that FINRA should publish short interest position data for all unrestricted over-the-counter (“OTC”) and exchange-listed securities, rather than only for OTC securities, as FINRA does now. Centralizing all of these disclosures at FINRA would provide investors with a single free source to conveniently access this information, rather than requiring investors to obtain this information separately from FINRA and multiple exchanges.

¹ Organized in 1919, NASAA is the oldest international organization devoted to investor protection. NASAA’s membership consists of the securities administrators in the 50 states, the District of Columbia, Canada, Mexico, Puerto Rico, and the U.S. Virgin Islands. NASAA is the voice of securities agencies responsible for grass-roots investor protection and efficient capital formation.

² The Proposal is available at <https://www.finra.org/rules-guidance/notices/21-19>.

Second, NASAA believes FINRA should publish – and require member firms to report – short positions on a daily basis (with a suitable delay if necessary to allow firms to compile this information). The current bi-monthly reporting regime was instituted in 2007.³ However, NASAA understands that daily short interest data can currently be purchased. The fact that this information is already available shows that it is not unduly burdensome to compile.

Third, FINRA should require member firms to separately report short interest in the firm's proprietary accounts and across customer accounts. FINRA should then publish the aggregate short interest data, reserving the individual account-level data for regulatory purposes only. Requiring broker-dealers to report account-level information to FINRA on a daily basis should not pose an undue burden. After all, broker-dealers should always know what assets belong to, or are owed to, their customers. Requiring firms to report short interest at the account level also would provide useful data for FINRA and other regulators tasked with overseeing the securities markets and preventing market manipulation. We acknowledge that compiling and reporting this data daily could be a complex exercise for FINRA members, and therefore FINRA should consider whether it is necessary or prudent to permit a suitable delay to provide firms time to create, error-check, and submit such reports.⁴

II. FINRA Should Not Implement Synthetic Short Interest Reporting Without Thorough Study and Market Research.

The Proposal seeks comment on whether FINRA should expand the scope of member firms' short interest reporting to include synthetic short positions. For example, FINRA could require firms to disclose as a synthetic short position a customer's combined sale of a call option and purchase of a put option where the two options have the same strike price and expiration month.⁵ The Proposal notes that there are other ways a synthetic short position can be created, such as through the use of securities-based swaps, and the Proposal asks whether FINRA should require firms to report these synthetic positions as well.⁶

While NASAA sees the potential benefits of such reporting in terms of market transparency and the ability to identify risks from accumulating short positions, we believe it would be premature for FINRA to mandate reporting of synthetic short positions given the complexities and hurdles that would need to be addressed to report such positions with confidence. However, we

³ See SEC Rel. No. 34-55406 (Mar. 6, 2007), available at <https://www.sec.gov/rules/sro/nasd/2007/34-55406.pdf>.

⁴ We believe the current delay for bi-monthly reporting – *i.e.*, 6:00 p.m. ET on the second business day after settlement – could be a suitable delay for daily reporting.

⁵ See Proposal at 4.

⁶ *Id.*

encourage FINRA to thoroughly study this issue with the goal of potentially embarking on a rulemaking after the full implications of such a reporting regime are known.

Synthetic short positions, particularly those created through the use of swaps, are inherently complex. If FINRA were to engage in rulemaking in this area, it would need to establish clear standards for what does and does not constitute a reportable synthetic short position. As derivatives continue to evolve, especially non-cleared securities-based swaps, it appears likely that FINRA would have to keep updating its regulatory standards for what instruments or financial arrangements constitute a reportable synthetic short position. Any reporting regime also would have to consider and account for the separate margin and custody requirements applicable to securities-based swaps.⁷ Also, while the underlying infrastructure necessary to support daily reporting of traditional short interest positions exists, it is an open question whether the infrastructure to support daily reporting of synthetic short interest positions is similarly robust.

Further, assuming that FINRA could be confident of embarking on a rule proposal that would accurately capture synthetic short interest positions established by member firms, there is a separate information problem that should be considered before doing so: broker-dealers will not necessarily know when a customer establishes a synthetic short position. Synthetic shorts can be created in different ways and may exist through multiple broker-dealers. To take the simple example referenced above, if a customer creates a synthetic short by entering into a call option through one broker-dealer and a put option through another broker-dealer, the two firms likely would not know about the customer's combined positions, and thus the synthetic short would go unreported (assuming no prime brokerage arrangement is in place). Synthetic shorts established through securities-based swaps or other instruments pose a similar information problem.⁸ Accordingly, FINRA should not implement a mandatory reporting regime for synthetic short interest until and unless it is confident that such a regime can accurately capture synthetic short interest positions.

III. FINRA Should Pursue Initiatives in the Proposal to Better Track Arranged Financing and Failures-to-Deliver and to Include Additional Fields in FINRA's Public Short Interest Data Reports.

The Proposal seeks comment on whether FINRA should require member firms to report short interest positions that currently escape reporting under FINRA Rule 4560 because they are

⁷ See, e.g., SEC Rel. No. 34-86175 (June 21, 2019) (setting capital, margin and segregation standards for cleared and non-cleared security-based swaps), available at <https://www.sec.gov/rules/final/2019/34-86175.pdf>.

⁸ There are currently no single-stock futures trading in the marketplace. But if these financial instruments begin to be used again, they would pose yet another challenge to FINRA's ability to monitor market-wide synthetic short interest given that single-stock futures can be maintained in either a brokerage account or a futures account. See SEC Rel. No. 34-46473 (Sept. 9, 2002), available at <https://www.sec.gov/rules/final/34-46473.htm#VC1>.

maintained through arranged financing.⁹ In these situations, a customer borrows shares from the firm (or from a foreign affiliate of the firm) to close out an existing short position in the customer's account. The short interest thus still exists in the overall market for the security but it is no longer reportable under Rule 4560. NASAA supports closing this gap.

FINRA should revise Rule 4560 to capture short interest that is maintained through arranged financing. It is reasonable for FINRA to require broker-dealers to track and report these positions. If firms seek to profit from these programs, they should bear the cost of instituting compliance policies to track and report on them. Hopefully, firms have already done so. But to the extent firms cannot yet track and report this information, they should be compelled to do so as part of their obligations under Rule 4560.

The Proposal also seeks comment on whether FINRA should adopt a new reporting rule on failures-to-deliver. Currently, when a firm fails-to-deliver a security, FINRA will contact the clearing firm to determine whether the open position has been allocated to another broker-dealer to settle.¹⁰ These inquiries help ensure that settlement is effectuated in a timely manner and that the markets function smoothly.

FINRA proposes to develop a new rule that would require member firms to report daily on their failures-to-deliver and whether these positions have been allocated to other members for settlement. This change would simplify FINRA's daily inquiries into failures-to-deliver and aid in FINRA's oversight of the securities markets. These daily reports would be for regulatory purposes only and would not be disclosed publicly. NASAA supports this common-sense initiative. Instituting such a rule would benefit investors by adding efficiencies to FINRA's market oversight while the impacts on FINRA member firms would be minimal. Doing so may also increase the likelihood that firms will comply with their settlement requirements in a timely fashion.

Finally, the Proposal seeks comment on whether FINRA should include three additional data fields in its public short interest reports: (a) total shares outstanding; (b) public float; and (c) whether a security is a threshold security as defined in Rule 203 of Regulation SHO.¹¹ NASAA supports this change. Including this information in FINRA's data reports would be helpful for investors as it would save them the burden of finding this information separately on their own. In addition, as the Proposal notes, FINRA can compile this information itself.¹² This change accordingly would not impact FINRA members.

⁹ See Proposal at 4.

¹⁰ *Id.* at 6.

¹¹ See 17 C.F.R. § 242.203(c)(6).

¹² See Proposal at 4.

IV. Conclusion

For the reasons expressed herein, NASAA is broadly supportive of the Proposal and the initiatives outlined therein. We look forward to seeing concrete rulemaking proposals from FINRA on these issues. If you have any questions or would like additional information, please do not hesitate to contact the undersigned or NASAA's General Counsel, Vince Martinez, at (202) 737-0900.

Sincerely,

A handwritten signature in black ink that reads "Melanie Senter Lubin". The signature is written in a cursive style with a large initial "M".

Melanie Senter Lubin
NASAA President
Maryland Securities Commissioner