

“Get Shorty” – FINRA Requests Comment on Proposed Significant Changes to Short Position and Stock Loan Reporting

June 7, 2021

On June 4, 2021, the Financial Industry Regulatory Authority (FINRA) published Regulatory Notice 21-19 (the Notice), which requests comment on certain significant proposed changes to short position and stock loan reporting. Currently, FINRA Rule 4560 generally requires clearing firms/prime brokers that are FINRA members to report to FINRA twice per month aggregate settled short positions in firm and customer accounts, subject to certain exceptions. The short interest data collected by FINRA includes the reporting firm's current aggregate settled short positions for each security and any short position changes at the firm since the prior reporting period. FINRA has requested comment on proposals that would, among other things, (i) increase the frequency of short interest reporting from twice per month to weekly or even daily; (ii) require clearing firms to report synthetic short exposure (e.g., long puts/short calls) in firm and customer accounts; (iii) require clearing firms to report loan obligations resulting from arranged financing and enhanced lending programs; (iv) require clearing firms to report to FINRA for regulatory purposes a report of daily allocations of fail to deliver positions under Rule 204(d) of Regulation SHO; and (v) consider requiring FINRA member firms to report to FINRA (for regulatory purposes but with an eye toward eventual public dissemination) certain information on stock loans.

While FINRA did not so indicate in the Notice, these proposed changes are likely in response to all of the scrutiny surrounding the market volatility involving Gamestop, AMC, and other stocks that have occurred since January 2021.

Summary of Proposed Changes

Publication of Short Interest for Exchange-Listed Equity Securities. FINRA is considering consolidating the publication on the FINRA website of short interest data reported to FINRA for both listed and unlisted securities. This should not require changes to firms' short interest reporting requirements.

Content of Short Interest Data. FINRA is considering the following changes to reported and disseminated short interest data, including whether the additional data points proposed to be collected should be disseminated publicly or used only for regulatory purposes:

1. **Proprietary and Customer Account Categorization.** FINRA is considering requiring firms to, in addition to reporting the total short interest in a security, segregate (i) short interest held in proprietary accounts and (ii) short interest held in customer accounts. FINRA believes that this information would provide beneficial regulatory information regarding the type of market participant that accumulated a short interest position (i.e., a firm or a non-broker-dealer customer).
2. **Account-Level Position Information.** Alternatively, FINRA is considering requiring firms to report (for regulatory purposes only, not to be disseminated publicly) short interest position information with more granularity by reporting at the account level for all equity securities. FINRA would use this to enhance its reviews for compliance both with Securities and Exchange Commission (SEC) Regulation SHO and FINRA's short sale rules.
3. **Synthetic Short Positions.** In addition, FINRA is considering requiring firms to reflect synthetic short positions (e.g., sales of calls and purchases of puts) in short interest reports.
4. **Loan Obligations Resulting From Arranged Financing (Enhanced Lending, Short Arranging).** FINRA is considering requiring members to report as short interest outstanding stock borrows by customers in their arranged financing programs to better reflect actual short sentiment in the stock.
5. **Total Shares Outstanding (TSO) and Public Float.** FINRA also is considering including in FINRA-disseminated short interest data, where available, the TSO and public float for securities.
6. **Threshold Security 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.

Frequency and Timing of Short Interest Position Reporting and Data Dissemination. FINRA is considering reducing the reporting timeframe to daily or weekly submissions, and, to enable FINRA to disseminate the collected information to the marketplace on a timelier basis, such reports also would be due to FINRA in a shorter timeframe following the applicable settlement date. For example, if FINRA were to require daily submissions, short interest reports could be due by 6 p.m. ET one business day after the designated reporting settlement date, and for weekly submissions, short interest reports could be due by 6 p.m. ET one business day after the weekly designated reporting settlement date (instead of the current requirement of two business days after the designated reporting settlement date).

Information on Allocations of Fail-to-Deliver Positions. FINRA is considering enhancing its short sale reporting program by adopting a new rule to require members to submit to FINRA (for regulatory purposes only, not for public dissemination) a report of daily allocations of fail-to-deliver positions to correspondent broker-dealers pursuant to Rule 204(d) of Regulation SHO. Obtaining daily information on fail-to-deliver allocations would allow FINRA to directly identify the introducing/correspondent broker-dealer that is responsible for a closeout obligation (without first requesting this information from the clearing firm) and therefore would allow FINRA to conduct more efficient investigations. The proposed allocation report may include the following fields:

1. security

2. identity of correspondent firm
3. amount allocated to correspondent firm (number of shares)
4. trade date(s)
5. allocation date
6. closeout date
7. applicable closeout obligation (T+3, T+5, or T+35)

Request for Comment on Other Stock-Lending-Related Initiatives. FINRA requests comment on whether to create 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 — for example, rebate rate (for new loans, open daily loans, and re-rates), loan amount, and contraparty 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.

What This Means to You

Clearing Firms/Prime Brokers: The proposed changes would clearly have the most significant effects on clearing firms/prime brokers, who bear the primary responsibility for short interest reporting. Even under the current reporting regime, clearing firms/prime brokers incur significant resources in collecting short positions, determining reportable versus nonreportable positions, submitting short positions to FINRA and engaging in followup reviews to respond to FINRA inquiries. Increasing the data that needs to be reported while also increasing the frequency of reporting to weekly or even daily will impose significant burdens on clearing firms/prime brokers to ensure reporting occurs on an accurate and timely basis, especially in light of the significant penalties FINRA has generally imposed for inaccurate reporting. Clearing firms/prime brokers will likely need to engage in significant programming efforts to capture in their short interest reporting information that is not currently collected, such as synthetic short positions and loans due to arranged financing. The disclosure of Rule 204(d) allocations also puts a premium on clearing firms' procedures for determining that their allocations of fails are "reasonable" in compliance with Rule 204.

Introducing/Correspondent Brokers: While clearing firms bear the responsibility for short interest reporting, the proposed changes would increase the transparency of accounts holding short positions as well as provide FINRA with increased transparency into situations where introducing brokers have been allocated fails to deliver by their clearing firms and thus where such introducing brokers (and not the clearing firms) bear the responsibility for Rule 204 closeouts. Thus, it is likely that introducing/correspondent broker-dealers allocated fails would receive more inquiries from FINRA to demonstrate proper Rule 204 closeouts.

Hedge Funds and Other Clients of Clearing Firms/Prime Brokers: While prime brokers would bear the direct responsibility for short reporting, the FINRA proposals could increase the transparency of short positions existing in the prime brokers' client accounts, to include synthetic short positions established through derivatives and arranged financing/enhanced leverage programs. Separately, the SEC has announced that it is considering whether to require market participants to disclose short positions

directly to the SEC.

The full text of the Notice is available [here](#). FINRA is accepting comments through August 4, 2021.

CONTACTS

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