

MEMO# 35507

November 9, 2023

SEC Adopts Final Rule on Short Position and Short Activity Reporting by Institutional Investment Managers

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TO: Derivatives Markets Advisory Committee
Equity Markets Advisory Committee
SEC Rules Committee RE: SEC Adopts Final Rule on Short Position and Short Activity Reporting by Institutional Investment Managers

On October 13, the Securities and Exchange Commission (SEC) adopted a final rule to require institutional investment managers under new Rule 13f-2 to report certain short position and related activity data for equity securities through a new Form SHO.^[1] ICI previously submitted a comment letter recommending certain changes to the SEC's proposed approach.^[2] The SEC adopted the final rule as proposed in most important respects, with several modifications that we highlight further below.

Gross Short Position Information

As adopted, an institutional investment manager^[3] whose gross short positions meet or exceed the following quantitative thresholds must file Form SHO to the SEC on a monthly basis:

- For any equity security that is of a class of securities that is registered under Section 12 or for which the issuer subject to Section 15(d) of the Exchange Act (a "reporting company issuer"), a position that meets or exceeds either (i) a monthly average of daily gross short positions at the close of regular trading hours in the equity security with a value of USD \$10 million or more; or (ii) a monthly average of daily gross short position as a percentage of shares outstanding in the equity security of 2.5 percent or more ("Threshold A"); or
- For any equity security that is of a class of securities of a non-reporting company issuer, a position that meets or exceeds a gross short position in the equity security with a value of \$500,000 or more at the close of trading hours on any settlement date during the calendar month ("Threshold B").

With respect to the thresholds, the SEC made one significant modification. Specifically, the SEC modified Threshold A to a monthly average from a daily calculation as had been

originally proposed, which otherwise could have been met on any settlement date during a given month. A "monthly average" would be calculated by determining a gross short position at the close of regular trading hours in the equity security (as defined in Rule 13f-2) on each settlement date during the calendar month and multiplying that figure by the closing price at the close of regular trading hours on the settlement date ("end of day dollar value"). A manager would then add all end of day dollar values during the calendar month and divide that sum by the number of settlement dates in the month to arrive at a "monthly average." This change, according to the SEC, would focus the reporting on managers who "consistently carry large [] positions" and distinguish directional short selling from activity effected by market makers and liquidity providers.

However, the SEC declined to adopt other recommendations, including (1) raising the 2.5 percent threshold, which it believes would have resulted in less transparency; (2) establishing a single threshold metric in lieu of the two-pronged approach; and (3) adopting a "net" short position threshold rather than a gross threshold, which it believes would have led to a less complete view of overall short positions in a particular security.

With respect to the information to be reported on Form SHO for a gross short position (Information Table 1), the SEC adopted the rule largely as proposed.^[4] However, consistent with ICI's recommendation, the SEC eliminated the proposed requirement of reporting whether the short position is fully hedged, partially hedged, or not hedged. Based on the comments received, the SEC acknowledged that such information may not provide consistent and accurate data as originally intended.

Daily Activity Information

In addition to reporting gross short position information, the SEC also adopted a requirement to report daily activity that affects the gross position during the given reporting period (Information Table 2). Although a manager must still account for the numerous types of purchase and sale activity as originally proposed,^[5] the SEC amended the manner through which this information is to be reported on Form SHO. Rather than report the activity for each type of purchase or sale individually, a manager instead must calculate and report the net change in position across those activities (expressed as a single identified number of shares). The SEC acknowledged that it would receive less granular information than proposed, but it believes that this would address cost and data security concerns (i.e., the SEC would not possess the data to perform this calculation itself), with no change in the net activity information that the SEC intends to make publicly available through aggregate reporting.

Timing of Form SHO Submission

Managers will be required to file Form SHO to the SEC within 14 calendar days after the end of the calendar month that is the reporting period. The SEC declined to provide additional time for managers to complete and file Form SHO, finding that 14 calendar days is sufficient.^[6]

Amendments to Form SHO

Similar as proposed, amendments to a Form SHO to correct errors would need to be filed within 10 calendar days of discovery of the error and restate the form in its entirety, with a written description of the revision being made, the reason for the revision, and an indication of whether data from any additional prior reporting periods up to the past 12 calendar months are affected by the amendment. If there are other affected reporting calendar months, then the manager would need to complete and file a separate filing for

each affected month. However, the SEC did not adopt the additional proposed requirement that a manager separately notify the SEC of significant revisions with an explanation.

Publication of Aggregated Data

The SEC adopted its proposed approach for publishing aggregated information derived from Form SHO filings. Specifically, the SEC will publish information for each class of equity securities across all reporting managers within one month after the end of the reporting calendar month. For gross short positions, the SEC will publish an aggregated number of total shares at the close of the last settlement date of the calendar month and the corresponding US dollar value. For daily activity, the SEC will publish the net activity in the reported equity security, aggregated across all reporting managers, for each individual settlement date within a calendar month reporting period.

Applicability to ETFs and Derivatives

The SEC affirmed in the final rule, as originally proposed, that Rule 13f-2 also applies to ETFs. Therefore, gross short positions in ETFs that meet the prescribed thresholds are subject to reporting via Form SHO. However, for purposes of calculating gross short positions for individual equity securities, a manager would not be required to consider short positions that an ETF holds in those individual underlying equity securities that are part of the ETF basket.

The SEC also clarified instances in which Rule 13f-2 applies to other securities such as derivatives. Specifically, the rule applies to derivatives, options, warrants and convertibles that meet the definition of equity securities under the Exchange Act. However, a manager does not have to account for economic exposure to an underlying equity security created by an equity derivative when calculating the gross short position for that underlying security. In reporting daily activity related to that gross short position, a manager would be required to account for activity in options, tendered conversions, secondary offering transactions, and other equity derivatives that might affect the reported gross short position.

Buy to Cover Requirement

Based on the comments received, the SEC determined not to amend Rule 205 under Regulation SHO to establish a "buy to cover" order marking requirement for certain purchase orders effected by a broker-dealer for its own account or the account of another person at the broker-dealer.^[7] The SEC noted the numerous operational issues with such a requirement that require further consideration.

Compliance Date

The SEC adopted a compliance date of 12 months after the effective date of the final rule, which is January 2, 2024. The SEC will begin publishing the aggregated short sale data three months after the compliance date.

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Notes

^[1] Short Position and Short Activity Reporting by Institutional Investment Managers,

[2] Letter from Sarah A. Bessin, Associate General Counsel, and Nhan Nguyen, Assistant General Counsel, ICI to Vanessa Countryman, Secretary, SEC (Apr. 2, 2022), available at <https://www.ici.org/system/files/2022-04/34125a.pdf>.

[3] Similar to the proposal, the final rule utilizes the definition of "institutional investment manager" under Exchange Act Section 13(f)(6)(A), which includes any person, other than a natural person, investing in or buying and selling securities for its own account, and any person exercising "investment discretion" with respect to the account of any other person. Rule 13f-1(b) specifies that "investment discretion" is defined under Section 3(a)(35) of the Exchange Act and further specifies that an institutional investment manager also exercises "investment discretion" with respect to all accounts over which any person under its control exercises investment discretion.

[4] With respect to the gross short position, the manager must identify the issuer and the security, the number of shares held short (without including any offsetting economic positions (including shares long of the equity security or derivative positions of the security)) at the close of the last settlement date of the calendar month of the reporting period; and the US dollar value.

[5] With respect to daily activity, the manager must report information for each settlement date during the calendar month of the reporting period, including the number of shares of the security sold short and the number of shares purchased to cover an existing short position (in whole or in part). Further, the manager must report information on whether, how, and when reported gross short positions are being reduced, closed out, created or increased due to the acquisition or sale of shares resulting from call option exercises or assignments; put option exercises or assignment; tendered conversations; secondary offering transactions; and other activity.

[6] ICI had recommended that the SEC align the proposed timelines for preparing and submitting Form SHO filings with other existing filing requirements, such as those for Form N-PORT filings (i.e., 30 days after the end of the month, rather than 14 calendar days).

[7] ICI had expressed support for this requirement to the extent that the SEC sought to require information on closeout of open short positions. ICI's support was based in part on the SEC determination to not require customers to provide their broker-dealers with this information, including positions held across multiple accounts.