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April 26, 2022

Ms. Vanessa A. Countryman
Secretary Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: File No. S7-08-22; Rule Proposal: Short Position and Short Activity Reporting by Institutional Investment Managers; Notice of Proposed Amendments to the National Market System Plan Governing the Consolidated Audit Trail for Purposes of Short Sale-related Data Collection (Release No. 34-94313)

The Security Traders Association[1] ("STA") appreciates the opportunity to provide comments in response to the aforementioned proposal (the "Proposal")[2] published by the U.S. Securities and Exchange Commission ("SEC" or "Commission"). STA is an organization comprised of individuals who are involved in the trading of financial securities in the U.S and Canada. Our members are employed at retail brokerage firms, agency only broker-dealers, asset owners and managers, market makers, liquidity providers and exchanges.

The Proposal seeks to introduce new Rule 13f-2 under the Securities Exchange Act of 1934 (Exchange Act) and new proposed Form SHO, which would require institutional investment managers (as such term is defined under Section 13(f)(6)(A) of the Exchange Act (Institutional Investment Managers)), to report to the SEC extensive information on certain "large" short positions and short sale and other transactions on a monthly basis. The SEC would then use this data to make publicly available by issuer aggregate data about short positions and short sale activity.

The Proposal also includes new Rule 205 of Regulation SHO to require broker-dealers to mark purchase orders as "buy to cover" when purchasing to cover short positions for the broker-dealer's own account or for the accounts of customers and require the reporting to the Consolidated Audit Trail ("CAT") of such "buy to cover" order marking

[1] STA is a trade organization founded in 1934 for individual professionals in the securities industry. STA is comprised of 24 affiliate organizations in North America with individual members who are engaged in the buying, selling and trading of securities. STA is committed to promoting goodwill and fostering high standards of integrity in accord with the Association's founding principle, Dictum Meum Pactum – "My Word is My Bond." For more information, visit https://securitytraders.org/.

[2] *See* 87 FR 16590 (March 16, 2022).

information as well as situations where short sales are effected in reliance on the "bona-fide market maker exception" to the Regulation SHO "locate" requirement.

The Proposal states the additional short sale, short position and activity information would, among things:

- Enable the SEC to reconstruct significant market events, particularly in times of increased market volatility.
- Allow investors to more accurately evaluate market movements and make more informed investment decisions, reducing manipulative conduct and increasing investor confidence.
- Help regulators' oversight of short selling and deter types of abusive and manipulative behaviors such as "bear-raids" and "naked" short selling, potentially by alerting regulators to suspicious activity.
- Identify short sales by Industry Members for which they are claiming the bona fide market making exception, thus providing regulators an additional tool to determine whether such activity qualifies for the exception, or instead could be indicative of, for example, proprietary trading instead of bona fide market making.
- Help the Commission identify instances in which an increase in "buy to cover" orders in a particular equity security coincides with an increase in price and/or borrowing costs in the same equity security, and thus identify where "short squeezes" may be occurring.

STA agrees it is valuable for the SEC to have access to further data and transparency into short sale, short position and activity information for the purposes of surveillance, reconstructing market events, and identification and investigation of any potentially abusive trading practices, among other important purposes. However, the Proposal goes far beyond the Section 13(f)(2) of the Exchange Act, which was enacted as part of the Dodd-Frank Act mandate to prescribe rules providing for public disclosure of short sales.

We respectfully submit the following comments and recommendations which we believe align with the mandates provided by Section 13(f)(2) and will achieve the Commission's stated intended goals more efficiently – as measured by quality of data, costs, and a shorter implementation time – and with less risk of creating unforeseen consequences.

A. Bona Fide Market Making Exception ("BFMM")

Quality Data
Generally speaking, violations of rules result from either nefarious behavior by bad actors or some kind of human error, such as a misinterpretation of the rule or poorly designed compliance technology. As the Proposal notes, firms are not permitted to use the bona fide market making exception for, among other things, speculative selling strategies or investment purposes of the broker-dealer that are "disproportionate" to the usual market making patterns or practices of the broker-dealer in that security. Identifying unusual patterns of activity is best obtained through diagnostic tools that use actual activity, or in this case actual short sale transactions. Adding the BFMM reporting requirement will not improve the ability of regulators to identify violations of the BFMM exception because the data can be manipulated by bad actors and is susceptible to human errors of inappropriately marking short sales with the BFMM indicator when they are not eligible.

STA recommends that regulators use actual and existing short sale data available from the Consolidated Audit Trail in recognizing activity it describes as "disproportionate to the usual market making patterns of practices of the broker-dealer."

Clarity on BFMM Exception
Additionally, the SEC notes in the Proposal that there have been several enforcement cases alleging failures to comply with the locate requirement where broker-dealers inappropriately claimed the BFMM exception. It has been the experience of our member's firms that regulators have been conducting examinations probing the use of the BFMM exception. We believe the problem with identifying what is and what is not appropriate is that the scope of the BFMM exception has not been well defined by the SEC. An example is OTC market makers that provide extensive liquidity for retail trades but do not affect the trades pursuant to published quotations.

In situations where there is a pattern of enforcement or regular inquiries, it is a responsibility of the primary regulator to determine if the rule in question is clearly defined. We do not believe the BFMM exception is clearly defined, therefore, we believe the more pressing need is for the SEC to clarify its views on the scope of the BFMM exception.

STA recommends that the SEC clarify its views on the scope of the BFMM exception.

Impact to Market Making and Market Quality
It has long been STA's view that investors benefit from enhanced liquidity provided by market makers and block traders during slow- and fast- moving markets. Enhanced liquidity is liquidity that exceeds what is publicly available in the marketplace and is often the result of capital commitment. The Commission states that it does not believe

requiring the BFMM exception indicator will have a chilling effect on market making generally. However, STA believes that the costs imposed on market makers implementing and maintaining the proposed regulatory requirements will be recouped in the form of wider spreads resulting in increased costs to investors. For new entrants, the required exception indicator will represent a cost that will increase the barrier to entry. STA believes the BFMM exception indicator will not achieve the Commission's goals, and any costs associated with facilitating it is counterproductive to enhancing liquidity.

STA believes in the benefits of enhanced liquidity and recommends that regulators find a modern way to incentivize it.

B. "Buy to Cover"

Not Feasible

In addition to representing the interests of STA members, STA participates on industry working groups organized by the Financial Information Forum("FIF").[3] As such, we share and support the observations and recommendations made by FIF in their comment letter to the Commission which exclusively focuses on the proposed "buy to cover" reporting requirements to CAT for institutional managers, retail, and firm accounts. FIF provides an extensive list of reporting and implementation issues, common trade scenarios where additional guidance is needed, and alternative approaches to achieving the intended goals of the Proposal.

STA agrees with FIF that the Proposal would impose tremendous costs on industry firms by essentially forcing them to keep two separate position aggregations. Like FIF, STA believes that the approaches proposed by the Commission for reporting the buy to cover order marker for institutional, retail, and firm accounts are not feasible.

STA supports FIF's comment letter to the Commission on the Proposal. STA recommends that the Commission should reissue the Proposal to solicit comment on the alternative approaches identified by FIF and other commenters.

Firm Exemption

[3] FIF (www.fif.com) was formed in 1996 to provide a centralized source of information on the implementation issues that impact the securities industry across the order lifecycle. Our participants include broker-dealers, exchanges, back office service bureaus, and market data, regulatory reporting and other technology vendors in the securities industry. Through topic-oriented working groups, FIF participants focus on critical issues and productive solutions to technology developments, regulatory initiatives, and other industry changes.

In addition to supporting input provided by FIF in its letter to the Commission, STA recommends that whatever the Commission decides to do with the "buy to cover" reporting requirement, consideration be given for an exemption to firms with low amounts of "buy to cover" order types.

The Commission estimates that of the 3,551 registered broker-dealers, 1,218 place orders that would require a "buy to cover" order mark. The Commission staff estimates that a total of approximately 62.25 billion "buy to cover" orders would be entered annually. However, the proposal does not provide any detail on that activity by groups of firms. It is our view that the vast majority of "buy to cover" orders are generated from a small percentage of broker-dealers. Given the estimated one-time cost of $170,000 per broker-dealer we believe an exemption to the reporting requirement should be provided to firms who account for a small percentage of "buy to cover" order types. Providing such an exemption would not degrade the additional context to the SEC regarding the lifecycle of short sales. In addition, an exemption would also prevent harm to broker-dealers who don't support "buy to cover" order types due to its expensive reporting regime.

STA recommends the SEC provide an exemption to the "buy to cover" reporting requirement for broker-dealers who generate a small percentage of "buy to cover" order types.

C. Rule 13f-2 and Form SHO

Form 13F Filings vs New Rule 13f-2

It is STA's view that shareholder information from Form 13F Filings on long positions contributes to the efficient trading of securities and is useful in the investment decisions of self-directed retail investors. Investors and the public benefit from information on the investment opinions of large shareholders, including insiders, who by their nature are generally more sophisticated and informed.

The design of Form 13F, in particular, that it does not require daily calculations of activity, present a reasonable burden on managers with as little as $100 million in assets under management ("AUM") to comply with. Additionally, the existing reporting timeline of 45 days provides adequate protection to managers from being harmed by what is commonly referred to as "front running." In a September 25, 2020, letter[4] to the Commission, STA opposed the SEC's proposal to raise the reporting threshold for managers from $100mln AUM to $3.5bln AUM citing that, "the information provided in

[4] Letter to Vanessa Countryman, Secretary, U.S. Securities and Exchange Commission; Release No. 34-89290; File No. S7-08-20; Reporting Threshold for Institutional Investment Managers

Form 13F is one significant variable that is beneficial in providing transparency in the investment process and plays a critical role in the trading and availability of liquidity in securities,…" Finally, it is our view that the reporting regime for Form 13F filings balance the interests of issuers, managers and investors.

STA believes that similar benefits received for investors can be obtained from the public disclosure of short positions held by large managers. The reporting regime for such a process should incorporate the primary attributes in Form 13F which result in reasonable costs to implement, while balancing the interests of issuers, managers, and investors. Unfortunately, there are material differences between Form 13F and new Rule 13f-2 with Form SHO. That is because as the Commission states, "while the primary focus of Proposed Rule 13f-2 and Proposed Form SHO is transparency, the Commission's regular access to the data reported on Proposed Form SHO would also bolster its oversight of short selling." This additional objective of bolstering oversight would create a regime that is overly complex and costly. We respectfully disagree with the Commission that compliance costs associated with determining whether a Manager is required to report on Proposed Form SHO and, if so, with filing Proposed Form SHO, pursuant to Proposed Rule 13f-2 are justified. As stated previously, STA believes the Proposal goes far beyond the Section 13(f)(2) of the Exchange Act, which was enacted as part of the Dodd-Frank Act mandate to prescribe rules providing for public disclosure of short sales.

STA recommends that the design of new Rule 13f-2 for the disclosure of short positions be more aligned with Form 13F Filings.

Conclusion

It is our view that the Proposal is a significant rulemaking as measured by the breadth of industry participants it covers (issuers, Managers, broker-dealers with retail investors, and broker-dealers who meet the definition of market maker), the amount of technology development required for new reporting requirements ("buy to cover"), short sales done under BFMM and daily calculations of short position activity), and costs to implement ($200,060,000 for "buy to cover"; $60,746,220 for Form SHO).

STA is very concerned with the recent Commission practice of 30-day comment periods for significant rulemaking proposals. The Proposal's 30-day comment period for feedback from the date of publication in the *Federal Register* is extremely insufficient and does not allow time for the public to understand its details nor provide a substantive analysis on costs and technological capabilities. STA believes the mere 30-

day comment period runs contrary to the Commission's actions historically, and to the guidelines for rulemaking set forth under the Administrative Procedures Act.[5]

STA expresses appreciation to the Commission Staff responsible for drafting the Proposal and providing data extremely useful in helping the industry formulate opinions and input, but we believe the industry and stakeholders could have played a meaningful and positive role in the Proposal's design had there been better engagement prior to its drafting.

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[5] https://www.archives.gov/federal-register/laws/administrative-procedure/553.html.