TWO SIGMA
100 Avenue of the Americas
New York, NY 10013
T +1 212 625 5700
F +1 212 625 5800

April 26, 2022

By Electronic Submission

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

Re: **Short Position and Short Activity Reporting by Institutional Investment Managers**, **RIN 3235-AM34, File No. S7-08-22**

Dear Ms. Countryman:

Thank you for the opportunity to comment on the proposed rule related to short position and short activity reporting by institutional investment managers. Two Sigma[1] includes two institutional investment managers that specialize in process-driven, systematic investment strategies and techniques, Two Sigma Investments, LP and Two Sigma Advisers, LP (collectively, "we", "our"). We perform quantitative analysis to build strategies, and implement those strategies using technology-driven investment, optimization, risk management, and techniques. These strategies and techniques guide our investment decisions in financial instruments regulated by the Securities and Exchange Commission ("SEC", or "Commission"). Taking short positions is an essential part of many of our market-neutral strategies. As a result, the Commission's proposed plan to require comprehensive daily reporting of functionally all short positions to the Commission raises a number of concerns for our firm.

I. We Applaud the Commission for Acknowledging that Any Requirement to Disclose Individual Short Positions Would Be Harmful

We applaud the Commission for acknowledging the harm to the market and investors that would likely arise from requiring institutional investment managers to publicly disclose their short positions. We agree that public disclosure of short positions would "facilitate copycat trading," "make holders of such short positions more susceptible to short squeezes," and "reduce the value

[1] Two Sigma is a group of financial sciences companies. We combine rigorous inquiry, data analysis, and invention to solve challenges in investment management, insurance, securities, private equity, and venture capital. Founded in 2001, Two Sigma employs over 1600 people, and has offices in New York, Houston, Portland, London, Tokyo, Hong Kong, and Shanghai.

of marketplace information gathered to develop a short selling strategy."[2] Beyond these points, the Commission goes into great detail in the proposal to explain the likely harms that public disclosure would cause individual managers.[3]

We would like to voice our agreement with the concerns raised by the Commission.

First, the disclosure of detailed individual short positions would harm the commercially sensitive, confidential information maintained by Two Sigma and other asset managers. These process-driven, systematic investment strategies and techniques are central to the value we provide our clients, and their disclosure would expose these commercially sensitive techniques. For firms such as Two Sigma who employ a process-driven investment approach, past positions can be used to predict future positions. Therefore, the disclosure of our past short positions, particularly in conjunction with our long position information that is already publicly available, would provide others with *our* roadmap to trading in the market and give competitors an unfair shortcut to the ideas our clients pay us to develop.

Disclosure of a time-series of our past short positions would enable others to replicate, front-run, or otherwise undermine our strategies. It is worth underscoring the fact that the confidential investment strategies we and others use on behalf of clients cease to work when they become common knowledge or are overused. If a firm's systematic strategies were revealed to the market, the disclosure of this information would, over time, undercut or destroy the firm's ability to continue using the disclosed strategies.

Second, public disclosure of individual short positions would provide, at best, incomplete information, and at worst, misleading signals to some well-intentioned investors. Although aggregate short interest can be a genuine signal of overall investor views regarding an issuer, the short positions of individual managers do not similarly provide unambiguous information to retail investors. Managers take short positions for many reasons other than having a negative view of an issuer. Reasons include maintaining a market-neutral portfolio, hedging risk from another investment, or expressing a view that, at a specific moment, a stock is slightly mispriced. Thus, a daily short position should not be seen as a signal to other investors that a manager has a negative view of a company. But in conducting research for their own investments, it is quite likely that some retail investors would misinterpret reports that large, sophisticated investors had

---

[2] Short Position and Short Activity Reporting by Institutional Investment Managers, 87 Fed. Reg. 14,950, 14,952 (Mar. 16, 2022) ("Short Position Proposal").
[3] *See id.* at 15,005–06.

a short position in an issuer as an indication they should also take similar positions, which can lead to herding behavior and other unintended consequences.[4]

II. The Proposed Rule Should Be Modified to Reduce Potential Harm

We commend the Commission for not requiring the disclosure of individual short positions, but are concerned that absent modifications the proposed rule will lead to potential harm to investors, the market, and market participants. While the Commission has proposed a regime of private position reporting by firms, we believe the regulatory benefit of the information the Commission is asking market participants to provide is far outweighed by the potential commercial harm from misappropriation or other disclosure of this information after it is provided to Commission.

A. The Proposal Requires Large Investment Managers to Put Commercially Sensitive Information at Risk by Reporting It to the SEC

The proposed rule contemplates managers such as Two Sigma disclosing to the SEC granular information on almost all their short positions. As noted in the proposal, 89 percent of short positions would be captured under the new Form SHO. For large investment managers like Two Sigma, in practice, almost all short positions would be reported.[5] Managers like us would be required to provide the Commission with detailed reporting of how our short positions changed each day for each covered security, regardless of the size of each daily position change. In practice, this means that a single monthly short position report from a large investment manager like us will likely contain thousands of data points. If made public, such detailed reporting would allow any sophisticated party that views it to understand how our positions evolve each day and allow that party to ascertain the patterns in our trading, which as described above reflect the strategies we have developed on behalf of our investors. These small daily fluctuations do not have significant regulatory value, but their disclosure exposes us to unlimited risk of commercial harm.

(i) The Risk Created By Reporting Granular Short Data to the Commission

Although the rule contemplates private reporting, the disclosure of this information from investment managers to the SEC creates substantial risk of exposure of this commercially

---

[4] *See* Sean Williams, *3 Popular Dividend Stocks Billionaires Are Piling Into*, Motley Fool, (Feb. 28, 2022), https://www.fool.com/investing/2022/02/28/3-popular-dividend-stocks-billionaires-piling-into/.
[5] *See* Short Position Proposal, 87 Fed. Reg. at 14,963.

sensitive information. First, once reported to the SEC, this information could be obtained by a hacker or by the broader market as a result of a data breach. This concern is, unfortunately, not hypothetical, as the SEC's systems have been subject to successful attacks in the past. In 2016, the SEC disclosed that individuals had illicitly accessed its EDGAR system. In its complaint against the hackers, the SEC stated that the hacker "launched several concurrent efforts to surreptitiously exfiltrate material nonpublic information located on the SEC's EDGAR servers" that resulted in "the false appearance that [the hacker] was an authorized user of the EDGAR system and ultimately allowed him to penetrate the EDGAR computer network to access certain nonpublic" information.[6] With this information, the hacker "capitalized on this advantage by initiating trades before the information was released to the market."[7] A similar misappropriation of the daily short position data could significantly undermine the commercial utility of a manager's strategies.

Second, even without a breach, there is a meaningful risk that the privately reported short position and related trading data could be publicly disseminated. As a case in point, European regulators have both accidentally and intentionally released similar information in the past. In January 2017, the Dutch regulator unintentionally revealed the confidential short position information of many market participants, including Two Sigma. While the disclosure was accidental and the Dutch regulator acknowledged it "regret[ted] this mistake", the positions became known by the market and revealed information about the strategies of market participants, including Two Sigma, when those participants were assured the information in that reporting would be kept private.[8] This incident provided the market with insights into the trading strategies of us and our peers, which makes those strategies less effective.

As another example, in late 2021, the Swedish financial regulator decided to release private short reporting information in response to freedom of information requests. While the Swedish regulator reversed course a few weeks later, the disclosure was unexpected, and reaffirmed our concern that private reporting to regulators can become public retroactively when policies change.

These incidents have taught managers like us to anticipate that private reporting may well become public. And that outcome is a worst-case scenario for process-driven fund managers like

---

[6] Complaint ¶¶ 55, 57, *SEC v. Ieremenko*, Civ. A. No. 19-cv-505 (D.N.J. Jan. 15, 2019), ECF No. 1.
[7] *Id.* ¶ 60.
[8] *Regulator Apologises for Accidentally Publishing Short Positions,* Reuters, (Jan. 26, 2017), https://www.reuters.com/article/dutch-financials-shorts/dutch-regulator-apologises-for-accidentally-publishing-short-positions-idUSL5N1FG252.

us, because past positions can often reflect future positions. As a result, sophisticated market participants can and likely will take advantage of any individual Form SHO data that becomes publicly available, join it with Form 13F long position data, and seek to reverse engineer trading strategies to front run or otherwise unfairly disadvantage the affected manager and its fund investors.

While we commend the Commission for acknowledging the concerns associated with public disclosure and requiring only private reporting to the SEC, investor reports will be private only so long as the Commission does not have its systems breached, its personnel do not misappropriate the information, the information is not unintentionally released, or policies do not change retroactively. Therefore, even private reporting poses very real risks of serious harm. And, as discussed below, in this instance, the potential commercial consequences of disclosure far outweigh the minimal benefits that the proposed reporting provides to the SEC.

(ii) The Commission Fails to Justify—and Dramatically Underestimates—the Burden and Cost of Proposed Rule 13f-2

The proposed rule would impose a set of operational burdens on investment managers that far exceed the burdens estimated by the Commission and are also more burdensome than available alternatives. Although the proposal included an estimate of the cost, that estimate dramatically underestimates the true burden. In the proposal, the Commission estimates that the burdens associated with filing proposed Form SHO would be similar to those that were temporarily imposed in 2008 with Form SH. Based on that comparison, the Commission estimates that filing Form SHO will require a total of 20 hours per filing spread across a compliance attorney, a senior programmer, and a compliance associate, for an approximate overall cost of $217.55 per filing.[9] Separately, the Commission estimates that managers will have to devote 325 hours—almost a fifth of a software engineer's full-year effort—for initial technology-related projects to facilitate Form SHO filings.

These estimates are not realistic and belie a material deficiency in the Commission's proposal for two reasons. First, as a procedural matter, the Commission's reliance on its prior 20-hour Form SH burden estimate is not adequately justified given the public comments the Commission received regarding Form SH and the Commission's decision to eliminate the filing. In September 2008, the SEC adopted Form SH without prior notice and comment pursuant to the

---

[9] Short Position Proposal, 87 Fed. Reg. at 14,973.

SEC's emergency powers under Section 12(k) of the Securities Exchange Act of 1934.[10] A month later, the SEC modified Form SH and adopted interim final temporary Rule 10a–3T.[11] In that adopting release, the SEC for the first time proffered its 20-hour burden estimate and requested public comment on, among other items, the burdens associated with the revised Form SH.[12] The Commission received many letters suggesting that it had underestimated the burden of Form SH,[13] and presumably those letters were taken into account when the Commission determined to let Rule 10a–3T lapse by August 1, 2009, and to work instead with several self-regulatory organizations to obtain short sale data through other more comprehensive and efficient means.[14] Neither the prior comment letters nor the Commission's cost-benefit analysis to let Rule 10a–3T lapse are discussed in the current Short Position Proposal. As a result, the Commission has not adequately explained why, notwithstanding comments to the contrary, it continues to hold fast to its 20-hour burden estimate.

Second, as a substantive matter, proposed Form SHO is significantly more complex than Form SH. As currently proposed, Form SHO requires managers to report daily trading activity and detail the rationale for changes in short positions. Specifically, to complete Information Table 2 for each monthly Form SHO filing, managers will not only have to look at their daily short positions and short selling activity, but also dissect their trading activity to determine if short

---

[10] Securities Exchange Act of 1934; Emergency Order Pursuant to Section 12(k)(2) of the Securities Exchange Act of 1934 Taking Temporary Action To Respond to Market Developments, 73 Fed. Reg. 55,175 (Sept. 24, 2008).

[11] Disclosure of Short Sales and Short Positions by Institutional Investment Managers, 73 Fed. Reg. 61,678 (Oct. 17, 2008).

[12] *Id.* at 61,686.

[13] *See, e.g.*, Letter from Ari Burstein, Senior Counsel, Investment Company Institute, to Florence Harmon, Acting Secretary, SEC at 8 (Dec. 16, 2008) (noting the "high costs" of developing and operating new systems to collect, compile and provide to the Commission short position and short sale trading data), https://www.sec.gov/comments/s7-31-08/s73108-47.pdf; Letter from Patricia A. Poglinco & Robert B. Van Grover, Seward & Kissel LLP, to Florence Harmon, Acting Secretary, SEC at 3–4 (Dec. 16, 2008) (noting that many filers have had "greater internal costs" than the Commission estimated), https://www.sec.gov/comments/s7-31-08/s73108-43.pdf; Letter from Stuart J. Kaswell, Executive Vice President and General Counsel, Managed Funds Association, to Florence Harmon, Acting Secretary, SEC at 8 (Dec. 15, 2008) (noting that managers "dedicate between two and four days of personnel time to filing Form SH"), https://www.sec.gov/comments/s7-31-08/s73108-41.pdf; and Letter from Melissa MacGregor, Managing Director & Associate General Counsel, Securities Industry and Financial Markets Association, to Elizabeth Murphy, Secretary, SEC at 11 (Dec. 18, 2008) (noting that the Commission's estimate for Form SH are "accurate" but that including data to capture the assignment and exercise of options as the Commission intends with proposed Form SHO would "cost each firm several million dollars and take hundreds of hours" to build the requisite systems), https://www.sec.gov/comments/s7-31-08/s73108-52.pdf.

[14] *See* Press Release, SEC, SEC Takes Steps to Curtail Abusive Short Sales and Increase Market Transparency (July 27, 2009), https://www.sec.gov/news/press/2009/2009-172.htm.

positions were closed out or increased as a result of call options exercises or assignments, put options exercises or assignments, tendered conversions, secondary offering transactions, and other activity. Attributing changes in short positions to specific drivers will require managers to develop complex system logic to sort data pulled from multiple sources and will, on a monthly basis, likely require considerable input from traders and investment professionals, which is not currently accounted for in Commission's proposal.

By contrast, Form SH merely required daily per issuer statistics on short positions (at the start and the end of each trading day) and total short sales executed; Form SH did not require any analysis of the drivers for changes to short positions. Form SH filings presented challenges for managers, but those burdens will prove to be relatively modest in comparison with proposed Form SHO, which requires monthly data for 9 elements and different daily data for an additional 16 elements, including an intricate attribution analysis for changes to short positions. Form SH burden estimates are an unrealistic benchmark for the challenges that lie ahead for managers if the Commission were to adopt Rule 13f–2 and Form SHO as proposed.

B. To Address the Potential Harm Created, The Commission Should Adopt Alternatives That Do Not Require Disclosure of Commercially Sensitive Information and Do Not Impose the Same Degree of Operational Burden

The commercial risk and operational burdens created by daily reporting of individual short positions are not adequately justified by the Commission's rationale for this proposal. The Commission states that daily information would "provide market participants and regulators with additional context and transparency into whether, how, and when reported gross short positions in the reported equity security are being closed out (or alternatively, increased)" and "would also assist the Commission in assessing systemic risk and in reconstructing unusual market events, including instances of extreme volatility."[15] But the Commission can easily modify existing reporting regimes to collect sufficient and timely information to accomplish these goals without imposing the additional daily position reporting requirements in proposed Form SHO.

As detailed below, the portion of the proposed rule requiring broker-dealers to provide additional information, in conjunction with the Commission's existing investigative powers, allows the Commission to collect all the information necessary to accomplish its regulatory goals. Alternatively, if the Commission believes it needs more information, it can enhance the FINRA short interest data to provide additional information. Or, instead of requiring daily transaction data as part of proposed Form SHO, the Commission could implement other approaches,

---

[15] Short Position Proposal, 87 Fed. Reg. at 14,959.

including strategies already implemented by other regulators. These alternatives, either individually or in combination, are superior to the SEC's proposed rule because they would achieve the same benefit while reducing the risk of harm from disclosure.

(i) The Commission's Other Proposed Rules, in Conjunction with The Commission's Existing Powers, Allow The Commission to Achieve All of Its Regulatory Goals

The Commission's proposed disclosure requirements for short data are unnecessary because the SEC's other proposed rules provide the SEC with sufficient information to achieve its regulatory goals. As part of the proposal here, the SEC plans to modify Reg SHO and Rule 613 governing the Consolidated Audit Trail ("CAT") to collect additional, order-by-order data on purchases to cover short positions. The CAT already tracks orders throughout their life cycle, and the Commission itself acknowledges in the proposal that the CAT is intended to "create a modernized audit trail system that would provide regulators with more timely access to a sufficiently comprehensive set of trading data, thus enabling regulators to more efficiently and effectively reconstruct market events, oversee market behavior, and investigate misconduct."[16] Under the proposal here, broker-dealers would have to collect and submit to the CAT additional data on "buy to cover" orders, which would permit the Commission to see if a short squeeze is occurring in close to real-time.

The order-by-order granularity of CAT data should be a rich source of context for the Commission and obviate the need for additional daily transaction reporting. In the proposal, the Commission states that the buy-to-cover data will "provide additional context to the Commission and other regulators regarding the lifecycle of short sales by identifying the timing of purchases that close out, in whole or in part, open short positions in a security."[17] The proposal, however,

---

[16] Short Position Proposal, 87 Fed. Reg. at 14,969. Importantly, the SEC has for years noted that the extraordinary costs of the CAT are justified because it would help reduce disparate reporting requirements and data requests. For example, in the adopting release for Rule 613, the Commission noted:

> The Commission believes that the creation of a consolidated audit trail may reduce the number and types of ad hoc requests made by regulators to market participants for data concerning their trading activities. In particular, regulators could use direct access to data in the consolidated audit trail for investigations or analyzing trends or broad market activities instead of requesting data from market participants. In addition, regulators could use this direct access to analyze the activities of a single trader across multiple markets, which today requires requests for data from multiple market participants.

Consolidated Audit Trail, 77 Fed. Reg. 45,722, 45,733 (Aug. 1, 2012).

[17] Short Position Proposal, 87 Fed. Reg. at 14,968.

does not articulate why imposing the burden of additional daily reporting on proposed Form SHO is warranted given the proposed enhancements to the CAT and Rule 205.

Relatedly, the currently proposed changes to Form PF would also provide the Commission with additional insight. Specifically, the proposed changes to Form PF would provide the Commission with information within one business day regarding "extraordinary investment losses, significant margin and counterparty default events, material changes in prime broker relationships, changes in unencumbered cash, operations events, and events associated with withdrawals and redemption."[18] This reporting would give the Commission insights into extreme volatility and the potential for systemic risk from rapid buying to cover in an even more timely manner than this proposed Form SHO reporting.

To the extent the Commission determines it needs to know more details about the trading activity of an individual market participant, the Commission also has broad authority—which it has used with frequency—to require the participant to provide this information immediately. The Commission has broad investigative powers to gather any information necessary to facilitate systemic risk assessments and to reconstruct unusual market events, including instances of extreme volatility. Given the sensitivity of granular daily short positions and the costs of disclosure, we believe specific requests for information as market events occur are a more useful, less burdensome, and less risky approach to reconstructing market events than requiring all major market participants to provide functionally all of their daily short positions.

(ii) Enhancing the FINRA Short Interest Data to Include Weekly Reporting Would Be A Preferable Alternative Way to Accomplish SEC's Goal

If the Commission concludes that its existing powers and its other proposed rules will yield insufficient information, it has an alternative that would allow it to obtain all the information it needs while mitigating the risk of harm: it can enhance the data that is already collected by FINRA today regarding the short interest in issuers. The FINRA short interest data is already sufficient to tell regulators whether the overall short interest in an issuer is relevant for assessments of systemic risk. The Commission, however, notes in the proposal that that information could be more comprehensive. But that observation merely points the way forward: the Commission could accomplish its goals by modifying this reporting regime to make it more frequent, timely, and comprehensive.

[18] SEC, Fact Sheet: Proposed Amendments to Form PF at 2 (Jan. 26, 2022), https://www.sec.gov/files/ia-5950-fact-sheet.pdf.

This approach has already been suggested by the Managed Funds Association. Specifically, in its 2022 Market Structure Recommendations, the MFA recommended that the SEC and FINRA "provide investors with greater transparency of short interest in equities through disclosure of aggregated short positions per security across all broker-dealers on a weekly basis."[19] This weekly reporting by broker-dealers would provide investors with visibility to the aggregate short interest in an issuer without putting at risk the confidential information of investment advisers. The dissemination of aggregated information thus will increase market transparency without harming investors, sacrificing the market benefits of short selling, or revealing proprietary trading strategies. Enhancing FINRA data would be a much less burdensome and costly way to obtain better data for systemic risk analysis purposes that would not imperil the trading strategies of investment managers.

(iii) Requiring Daily Transaction Data Is Not Necessary Where Other Regulators Have Already Adopted Other Approaches

If the SEC finds utilizing FINRA data undesirable, we would suggest the SEC gather information without requiring what amounts to daily transaction data. The Commission could, for example, gather information directly on a weekly basis. Alternatively, another simple way for the SEC to accomplish its goal of increasing transparency regarding when positions are closed out would be to require that the SEC be notified when a short position is opened and closed out or crosses a certain threshold, instead of requiring daily transaction data as part of proposed Form SHO. Other regulators have followed this targeted approach. For example, the European Union and United Kingdom require managers to notify the relevant regulator when their positions cross a ten basis point threshold in either direction. This approach informs the regulator of any change in position of significant size and also alerts the regulator to unusual market events such as a short squeeze.

III. The SEC Has Not Adequately Explained How Its Disclosure Requirements Will Assist It in Deterring Market Manipulation

In the absence of a specific rationale for the Commission's overbroad approach to proposed Form SHO, institutional investors are left to wonder whether the Commission has an unstated agenda that goes beyond Section 929(x) of the Dodd-Frank Act, which is the specific operative law for this proposal. Section 929(x) clearly calls for disclosure of aggregate short interest in issuers and we understand the Commission's proposed rule to be an attempt to achieve this

---

[19] Managed Funds Ass'n, *Promoting Fair, Efficient, and Transparent Markets* at 2 (Dec. 1, 2021), https://www.managedfunds.org/wp-content/uploads/2022/02/MFA-Market-Structure-Recommendations.pdf.

objective. However, throughout the proposal the Commission alludes to broader aims for the proposed reporting.

The Commission notes the release of this aggregate information could increase the risk of short squeezes, but confusingly then notes that the risk could be mitigated as "the Commission's improved detection of such potential manipulation could help deter it."[20] The SEC goes on to state, without additional explanation, that "if the Commission had the Proposed Form SHO data at the time [during the meme stock phenomenon of January 2021], then it would have had a clearer view as to which Managers held large short positions prior to the volatility event and thus which Managers were at greatest risk of suffering significant harm from a short squeeze."[21]

We have several concerns, both procedural and substantive in nature, with the Commission's suggestion that requiring disclosure of short data will assist it in combatting market manipulation:

- The notice of proposed rulemaking ("NPRM") is ambiguous on whether, in fact, the Commission is relying on this rationale as a basis for the proposed rule.

- The NPRM does not identify the Commission's statutory authority to mandate disclosure of short sales to use the data to combat market manipulation. Section 929(x) of Dodd-Frank was not enacted for this purpose and requiring disclosure on this basis would contravene congressional intent.

- The Commission does not state what market interventions it anticipates or how the short data will facilitate those interventions. As such, the hypothetical possibility of unspecified interventions cannot justify the proposed rule. The SEC cannot require disclosure of short data for purposes of combatting manipulation if the SEC cannot or will not articulate what it will do with the data. Likewise, commenters cannot offer their perspective on whether short data will assist the SEC's regulatory efforts if the SEC does not identify let alone explain those regulatory efforts. We believe the Commission should not seek data for the purpose of intervening in the market without a formal codification of how such action would occur following notice and comment.

- Finally, we substantively disagree with the Commission's apparent new approach to regulating short sales. We are concerned that the Commission taking an active role in

---

[20] Short Position Proposal, 87 Fed. Reg. at 14,992.
[21] *Id.* at 14,993.

trying to prevent investors with concentrated short positions from facing pressure on their positions as this proposal seems to contemplate would distort the market and have unintended consequences. Institutional managers who take short positions are keenly aware of the risks of those positions. Given this risk is known and accepted, the Commission's seeming desire to require more information about those investors' positions in order to somehow protect them from themselves, other investors, or market losses is unwarranted and suggests an extraordinary departure from the SEC's historic mission to maintain fair, orderly, and efficient markets, and facilitate capital formation.

In light of these concerns, we do not believe the Commission has adequately justified the need for yet another source of reporting to assess systemic risk or reconstruct market events. First, the Commission has not shown that requiring disclosure of short data would provide any regulatory benefits that the Commission could not obtain in a less burdensome way. Second, even if the Commission could show some minimal benefit from requiring disclosure of short data, that benefit would be far outweighed by the costs, both in terms of commercial risk and operational burden. Hence, a cost-benefit analysis does not justify requiring managers to report daily changes in their short positions to the SEC. Third, to the extent the Commission anticipates using this data for purposes of engaging in market interventions, the NPRM does not lay out the Commission's plans or its rationale and is therefore deficient.

IV. The Commission Should Adopt Enhanced Data Security Protocols Such as Those Used in the CAT

Despite the sensitivity of the data that would be reported under the proposed rule, the proposal does not address data security measures and it is unclear what protections will apply to this data. If the Commission ultimately requires investment managers to disclose information about their short positions, the Commission must implement corresponding data security protocols. There is no greater risk to our business than the disclosure of our trade secrets. Process-driven investment management firms have spent billions of dollars over many years to develop sufficient safeguards to protect the sensitive information they possess, and the absence of any discussion of data security measures in the proposal would require us to take on faith that the SEC will provide a similar level of protection.

Our regulators and clients demand we have cutting-edge systems in place to ensure all of our data (and theirs) remains safe. We would ask the Commission to put in place corresponding protections for the information it houses from its registrants, or otherwise not collect this information and instead require registrants to make it available for the SEC's review on-demand.

If the SEC compels disclosure of short data, we ask that this information be held to at least the same security standards used in the CAT. As part of the CAT program, the SEC has specifically recognized the sensitivity of the information that it collects and outlined the steps that it takes to preserve the confidentiality of the information. These steps include providing investors visibility into the security framework used and adopting specific protocols to ensure that information is used exclusively for the intended regulatory purpose for which it was collected. While we would suggest even more stringent controls than those used in CAT, the standards used in CAT should be seen as a new floor for the level of security required for such sensitive information.

V. The Alternative Approaches Referenced by the SEC Carry Great Risk and Should Not Be Adopted

The Commission referenced two alternative approaches in its proposed rule: (i) following the European Union's public disclosure of some short positions on a T+1 basis and (ii) releasing each managers' reporting of its short positions in anonymized but individualized forms. As detailed below, these alternative proposals create great risk and should not be adopted.

(i) Adopting EU-Like Public Disclosure Regime Would Create Harm

We do not believe the Commission should adopt a regime similar to the EU which requires public disclosure on a T+1 basis of positions that meet a certain threshold of an issuer's total position. As detailed above, the Commission has appropriately acknowledged that public disclosure of individual investment managers' short positions would create harm to investors, market participants, and the market. The research performed to date shows that investors modify their investment behavior to avoid taking short positions at a level that would require public reporting, thereby distorting markets. More specifically, analysis of the impact of the EU's Short Sale Regulation by the European Securities and Markets Authority (ESMA) found that trading data "reinforces the view that the public disclosure threshold seems to influence the market outcome of net short positions, likely driven by the behavior of some investors who avoid crossing the public threshold."[22] ESMA reached the conclusion that the public disclosure "threshold imposes a constraint on short selling that is binding for investors who avoid publicly disclosing a net short position in a particular share, i.e. investors who aim to keep their strategy secret from other investors."[23] These constraints have been shown by Germany's Bundesbank to

---

[22] European Securities & Markets Authority, *ESMA Report on Trends, Risks and Vulnerabilities*, No. 1 at 63 (2018), https://www.esma.europa.eu/sites/default/files/library/esma50-165-538_report_on_trends_risks_and_vulnerabilities_no.1_2018.pdf.

[23] *Id.* at 66.

"impose[] negative externalities on stock market efficiency."[24] We agree that public disclosure modifies investor behavior, which inhibits price discovery and leads to worse outcomes for market participants and companies seeking to raise capital.

(ii) The Public Reporting of Individual Managers' Positions Would Lead to Exposure of Commercially Sensitive Information

The Commission should not adopt any proposal to publicly disclose anonymized reports of individual investment managers' short positions. First, adopting such a proposal would lead to exposure of an investment manager's commercially sensitive trading positions. We believe that any disclosure of individual investment managers' short positions—even in anonymized form—would likely engender the same harms that arise from a public reporting regime of investment manager's positions—harms that the Commission aptly identified. In these circumstances, anonymizing the information does not truly protect investment managers' commercially sensitive information. Market participants are aware of the size and general trading strategies of their competitors and large market participants, and individualized short position data will be compared with fully attributed publicly available long position reports. As a result, publication of these reports in anonymized form would not, in fact, provide meaningful anonymity and would likely lead to all of the potential concerns the Commission highlighted as resulting from public disclosure of the short positions of individual firms. As in the case of straightforward public disclosure, "anonymized" disclosures will facilitate copycat trading, make holders of such short positions more susceptible to short squeezes, and reduce the value of marketplace information gathered to develop a short selling strategy. Further, as explained above, these grave potential harms are not justified by any regulatory benefit. Because managers take short positions for a number of reasons, visibility into individualized positions does not provide retail investors with meaningful information about the merits of any particular position. Indeed, given the likelihood that such short positions will be misconstrued, the information is more likely to harm retail investors than it is to help them.

* * *

We would welcome the opportunity to discuss this letter and engage in further dialogue with the Commission on these topics.

---

[24] Stephan Jank et al., *Flying Under the Radar: The Effects of Short-Sale Disclosure Rules on Investor Behavior and Stock Prices* No. 25 at *4 (2016), https://www.bundesbank.de/en/publications/research/discussion-papers/flying-under-the-radar-the-effects-of-short-sale-disclosure-rules-on-investor-behavior-and-stock-prices-662740.

TWO SIGMA

Respectfully submitted,

/MRL

Matthew B. Siano
Managing Director, General Counsel