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February 23, 2012

Via Electronic Mail (rule-comments@sec.gov)

U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090
Attention: Elizabeth M. Murphy, Secretary

Re: FINRA Proposal to Amend FINRA Rule 4560 (Short Interest Reporting) (File No. SR-FINRA-2012-001); Exchange Act Release No. 66220)

Dear Ms. Murphy,

The Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates the opportunity to respond to the request for comment by the U.S. Securities and Exchange Commission ("SEC" or "Commission") with regard to the Financial Industry Regulatory Authority, Inc.'s ("FINRA") proposal to amend FINRA Rule 4560 (the "Rule"), which sets forth requirements in connection with short interest reporting.[2] As discussed in greater detail below, SIFMA supports the apparent intent of the proposed FINRA amendments to remediate certain of the Rule's current limitations and generally require members to report short interest based on gross short positions in each customer and firm account. SIFMA recommends other essential adjustments designed to rationalize and enhance the efficiency with which member firms systematically report short positions based on gross short positions as reflected in the stock record. SIFMA further similarly recommends narrowing the exception from the Rule's reporting requirements for sales of certain "owned" securities to allow firms to more efficiently and properly report short interest, while still serving the policy objectives of the Rule.

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1 The Securities Industry and Financial Markets Association brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to develop policies and practices which strengthen financial markets and which encourage capital availability, job creation and economic growth while building trust and confidence in the financial industry. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA).

2 *See* Securities Exchange Act Release No. 34-66220 (Jan. 24, 2012), 77 FR 4599 (Jan. 30, 2012) (the "Rule Filing").

I. Report Gross Short Positions/Narrow Exception for Sales of Owned Securities

A. Reporting Gross Short Positions

Under the Rule, each FINRA member is generally required to maintain a record of total "short" positions in all customer and proprietary firm accounts in all equity securities (other than Restricted Equity Securities as defined in Rule 6420)[3] and is required to report such information to FINRA twice per month. Under the current version of the Rule, subject to certain exceptions, "short positions" to be reported are those resulting from "short sales" as that term is defined in Rule 200(a) of Regulation SHO under the Securities Exchange Act of 1934, as amended (the "Exchange Act").[4]

FINRA proposes to codify interpretive guidance previously issued by the Intermarket Surveillance Group ("ISG") instructing members to report "gross" short positions existing in each proprietary and customer account (rather than net positions across accounts). In this regard, the proposed rule change provides that members must report all gross short positions existing in each firm or customer account, including the account of a broker-dealer, that resulted from a "short sale" as that term is defined in Rule 200 of Regulation SHO, as well as where the sale transaction that caused the short position was marked "long," consistent with Regulation SHO, due to the firm's or the customer's net long position at the time of the transaction (*e.g.,* aggregation units).

SIFMA generally supports this proposed amendment regarding the reporting of "gross" short positions, as it recognizes certain inherent limitations and difficulties that may be associated with short interest reporting. SIFMA further highlights the difficulties of manually adjusting short interest reporting based on information that is not contained in a firm's stock record as being unduly difficult for members to process systematically and offering negligible, if any, material benefit in the reporting. For example, in certain situations where a broker-dealer (especially a clearing broker) is collecting gross short position information for purposes of complying with the short interest reporting requirements, the broker-dealer may not be privy to information concerning the execution of the order that resulted in the short position.[5]

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3 FINRA Rule 6420(j) defines the term Restricted Equity Security to mean "any equity security that meets the definition of "restricted security" as contained in Securities Act Rule 144(a)(3)."

4 Rule 200(a) of Regulation SHO defines a "short sale" as "any sale of a security which the seller does not own or any sale which is consummated by the delivery of a security borrowed by, or for the account of, the seller."

5 Indeed, the requirement to mark orders, under Rule 200(g) of Regulation SHO, belongs to the introducing broker and not the clearing broker. Thus, while the clearing broker is responsible for reporting short positions to FINRA, it is not responsible for determining how the orders contributing to such short positions were marked and, given the short time frame for reporting short interest, it would not be feasible for a clearing broker to obtain information from the introducing broker concerning whether the sale that resulted in the short position was marked "long," "short," or "short exempt." In that regard, the clearing broker generally has no knowledge of, among other things, the introducing broker's aggregation units, the use of complex account structures within an introducing

Given the volume of positions on firms' books and records, and the short time frames under which short interest reports must be submitted to FINRA, firms generally employ automated systems to collect reportable short positions. Considering the large number of transactions that may contribute to these short positions, it would be extremely difficult, if not impossible, for clearing brokers to determine manually whether positions should be excluded based upon information that is not contained in the stock record. Indeed, in certain situations it may be difficult for a firm to determine whether a short position resulted from a sale at all. Examples of such situations include the following:

- *Options Exercises and Assignments:* With respect to options exercises and assignments, the exercise or assignment of an option is generally not marked as either "long," "short" or "short exempt." This being the case, if the exercise or assignment results in a firm having a short position, such short position will generally be included as part of the gross short positions reported to FINRA. This would seem to be consistent with the policy goals of the Rule, as the holder of the option position is, in fact, economically short in the same manner as if a short sale had been effected in the open market.

- *Internal Transfers:* Firms often use internal matching systems that compare orders before sending them externally for execution. Thus, in a simple example, if one order to buy 100 shares of XYZ, and an order to sell 100 shares of XYZ, were submitted simultaneously, a firm's internal processes and systems could match the buy and sell orders. In certain situations, a short position can result from an internal transfer from one broker-dealer's account to another account of that same broker-dealer in connection with an internal match. Given the automated systems employed by firms, and the time restrictions of short interest reporting, it would be extremely difficult for firms to determine that a short position resulted from an internal transfer/journal and remove such position from the firm's short interest report. This information is not contained in the stock record and is not accessible. Again, it would also be consistent with the Rule's policy goals to include such short positions in short reporting, as the account would have economic exposure in the same way as if a short sale were effected in the open market.

- *Exchange Traded Funds:* In connection with the creation of an ETF, an "authorized participant" delivers a basket of securities to the fund's agent bank. In certain situations, the authorized participant may deliver borrowed securities, thus resulting in a short position on the firm's books and records. The firm may also sell short securities in the same account in which the ETF is created in order to rebalance the portfolio to accurately reflect the ETF. Standard brokerage accounting systems are not able to distinguish the firm

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broker, or positions held away or portfolio rebalancing entries (journals), all of which may impact how an introducing broker marks orders.

"short" positions resulting from borrows versus the short positions in connection with rebalancing. Because the "short" positions due to borrowing in connection with ETF creations cannot be differentiated systematically from other short positions using standard brokerage accounting systems, and both types of positions have the same economic effect with respect to the borrowing firm and the marketplace, SIFMA believes that these short positions should be included in firms' short interest reporting.

- *Foreign Securities:* SIFMA understands that FINRA has interpreted the Rule to require that a short position in a foreign-listed security must be reported when the security is dually-listed on a U.S. exchange under a different ticker.[6] SIFMA believes that such interpretation is problematic for a number of reasons. Foreign securities are generally not assigned a CUSIP number, but are assigned an ISIN number. Foreign securities are listed under a ticker that is not accepted by FINRA's short interest reporting systems. Manual intervention would be required for each member to identify each instance in which a foreign, unlisted security has a listed counterpart whose ticker is accepted by FINRA. SIFMA understands that because of the volume of transactions and the short time frames under which short interest reports are required to be reported to FINRA, many firms will utilize the services of a vendor for aggregating short positions to be reported on the firms' respective short interest reports. The vendors, however, aggregate positions based on CUSIP number and not ISIN number and do not facilitate linking the foreign ticker with the ticker accepted by FINRA. SIFMA believes that any possible benefit of requiring short positions in foreign securities to be included in the bi-monthly reports is outweighed by the time, effort and cost required to report such positions.

SIFMA therefore feels strongly that the Rule should be focused on requiring the reporting of all gross short positions appearing on a firm's books and records, subject to certain exceptions discussed below. SIFMA believes that such approach would allow firms to report short positions in a more efficient manner, while also serving the policy objectives of short interest reporting.

B. Narrowing the Exception for Sales of Owned Securities

While FINRA's proposed amendments would appear to recognize, and attempt to remediate, situations where clearing brokers may not be privy to execution information associated with short positions, SIFMA notes that FINRA also proposes to retain the current exception for short positions resulting from sales for an account in which the person "owns the security sold and intends to deliver such security as soon as possible without undue inconvenience or expense." FINRA notes that such exception is intended to address circumstances where there may be a brief delay in delivery, but the sale is a long sale, *i.e.,* due to exercise of a right, option or warrant. As explained above, in certain situations clearing

6 *See* NASD Notice to Members 06-20.

brokers may not be privy to information about the actual execution, including whether the short position resulted from a sale of an "owned" security. In these situations, it would be extremely difficult, if not impossible, for clearing brokers to obtain such information and then exclude such positions from the short interest report.

SIFMA would therefore recommend narrowing this exception to only cover those situations where: (i) the broker-dealer is relying on the exception provided in Rule 204(a)(2) of Regulation SHO for sales of a security that a person is deemed to own and will deliver as soon as all restrictions on delivery have been removed, subject to this exception only applying to the amount of shares for which the exception provided in Rule 204(a)(2) is claimed;[7] (ii) the short position resides in a customer cash account; or (iii) the short position resides in a customer DVP/RVP account.[8] Under this approach, if a short position resulted from any of these situations, the short position would not be included in short interest reporting. SIFMA believes that revising the exception in such manner would serve the policy goals of short interest reporting and would allow firms to more efficiently and accurately report short interest. In addition, revising the exception accordingly would address situations where a broker-dealer is clearing for broker-dealers who act as market makers or proprietary traders, where there generally will not be separate cash and margin accounts maintained, that would otherwise allow the clearing broker to be able to identify positions that should be excluded from short interest reporting.

II. Reporting Settled Short Positions

The Rule Filing states that FINRA is clarifying that members' short-interest reports must reflect only those short positions that have settled or reached settlement date by the close of the reporting settlement date designated by FINRA. SIFMA generally supports this clarification; however, we believe that the language should be revised to be consistent with FINRA's proposal concerning the reporting of gross short positions. Specifically, FINRA has stated that:

> "[t]herefore, short positions resulting from short sales that were effected but have not reached settlement date by the given designated reporting settlement date, should not be included in a member's short interest report for that reporting cycle."

Consistent with FINRA's proposal concerning the reporting of gross short positions, and the recommended adjustments discussed above, we believe that this language should state:

> "[t]herefore, short positions that have not reached settlement date by the given designated reporting settlement date, should not be included in a member's short interest report for that reporting cycle."

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7 The broker-dealer would thus remove from short reporting the amount of shares for which the exception in Rule 204(a)(2) is claimed.

8 A short position that resides in a customer DVP/RVP account or a customer cash account is generally due the customer failing to deliver securities that a customer owns.

III. Company-Related Actions

The Rule Filing states that FINRA is clarifying that members must reflect company-related actions in their short interest reports adjusted as of the ex-date of the corporate action (and if no ex-date is declared by a self-regulatory organization ("SRO"), then the payment date). Under FINRA's clarification, therefore, for purposes of short interest reporting, members would be required to reflect corporate actions that impact the total number of shares in the short position in their short interest report for a reporting cycle if the ex-date of the corporate action occurs by the reporting settlement date designed by FINRA for such cycle (even if payment of the distribution is not received and reflected in the stock record until after the designated reporting settlement date).

We believe that such proposed clarification is inconsistent with FINRA's other proposed amendments indicating that short interest reporting include only those short positions that have settled or reached settlement date by the close of the reporting settlement date designated by FINRA. Firms' systems for short reporting have been set-up based on reporting settled short positions.

Under the FINRA proposal, in situations involving corporate actions, even though a firm's stock record would not reflect the corporate action until payment date, the firm would be required to create a system and process to capture these positions as of the ex-date. Stated another way, a firm would be required to report short position information that is not consistent with the information maintained on the firm's stock record. In addition, firms' systems for compiling short interest position information for purposes of short interest reporting are not currently set up to process and capture positions as of ex-date. The extensive programming required to establish a new system to process and capture positions as of ex-date would require firms to incur significant costs, which SIFMA believes would outweigh any associated benefits.

IV. Proposal to Delete Certain Exceptions to the Rule

SIFMA supports FINRA's proposal to delete certain exceptions to the Rule, namely, the exceptions for stabilizing activity, domestic arbitrage and international arbitrage. Furthermore, as noted above, SIFMA believes it is necessary to narrow the exception for short positions resulting from sales of owned securities so that such exception only covers those situations where: (i) the broker-dealer is relying on the exception provided in Rule 204(a)(2) of Regulation SHO for sales of a security that a person is deemed to own and will deliver as soon as all restrictions on delivery have been removed, subject to this exception only applying to the amount of shares for which the exception provided in Rule 204(a)(2) is claimed; (ii) the short position resides in a customer cash account; or (iii) the short position resides in a customer DVP/RVP account.

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SIFMA greatly appreciates the Commission's consideration of the issues raised above in connection with the Rule Filing. SIFMA firms would appreciate the opportunity to engage in a dialogue with the Commission and FINRA Staff regarding the comments and recommendations outlined above.

If you have any questions, please call me at 202-962-7385.

Sincerely,

/Melissa MacGregor/

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