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SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-66872; File No. SR-FINRA-2012-001)

April 27, 2012

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Amendment No. 2 and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendments No. 1 and 2, to Amend FINRA Rule 4560 (Short-Interest Reporting)

I. Introduction

On January 10, 2012, Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“SEC” or “Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to amend FINRA Rule 4560. On January 20, 2012, FINRA filed Amendment No. 1 to the proposed rule change (“Amendment No. 1”).<sup>3</sup> The proposed rule change, as modified by Amendment No. 1, was published for comment in the Federal Register on January 30, 2012.<sup>4</sup> The Commission received one comment letter, from the Securities Industry and Financial Markets Association (“SIFMA”), on the proposal.<sup>5</sup> On April 23, 2012, FINRA responded to the comments in the SIFMA Letter<sup>6</sup>

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> Amendment No. 1 was a partial amendment that clarified the reference to a defined term in SEC Regulation SHO in the rule text and purpose section of the proposed rule change.

<sup>4</sup> See Securities Exchange Act Release No. 66220 (January 24, 2012), 77 FR 4599 (January 30, 2012).

<sup>5</sup> See letter from Melissa MacGregor, Managing Director and Associate General Counsel, SIFMA, to Elizabeth M. Murphy, Secretary, Commission, dated February 23, 2012 (“SIFMA Letter”).

and filed Amendment No. 2 to the proposed rule change (“Amendment No. 2” and collectively with Amendment No. 1, the “Amendments”).<sup>7</sup> The Commission is publishing this notice and order to solicit comments on Amendment No. 2 and to approve the proposed rule change, as modified by the Amendments, on an accelerated basis.

## II. Description of the Proposal

FINRA has proposed to amend FINRA Rule 4560. FINRA Rule 4560 (the “Rule”) requires each FINRA member 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) and regularly report such information to FINRA in the manner prescribed by FINRA. The Rule generally provides that the short positions to be recorded and reported are those resulting from “short sales” as that term is defined in Rule 200(a) of Regulation SHO.<sup>8</sup> FINRA has proposed to amend the Rule to

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<sup>6</sup> See letter from Racquel L. Russell, Assistant General Counsel, FINRA, to Elizabeth M. Murphy, Secretary, Commission, dated April 23, 2012 (“Response Letter”).

<sup>7</sup> Amendment No. 2 was a partial amendment that deleted the proposed requirement concerning the adjustment of corporate actions for short interest reporting purposes. The text of the proposed rule change and FINRA’s Response Letter are available on FINRA’s website at <http://www.finra.org>, at the principal offices of FINRA, on the Commission’s website at <http://www.sec.gov>, and at the Commission’s Public Reference Room.

<sup>8</sup> Rule 200 of SEC Regulation SHO provides that “short sale” means “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.” See Rule 200(a) of SEC Regulation SHO, 17 CFR 242.200. SEC Rule 200 further provides, among other things, that a person is deemed to own a security if: (a) The person or his agent has title to it; or (b) The person has purchased, or has entered into an unconditional contract, binding on both parties thereto, to purchase it, but has not yet received it; or (c) The person owns a security convertible into or exchangeable for it and has tendered such security for conversion or exchange; or (d) The person has an option to purchase or acquire it and has exercised such

clarify members' recording and reporting obligations and to delete several exceptions to the Rule.

First, FINRA has proposed to codify interpretive guidance previously issued by the Intermarket Surveillance Group (ISG) that instructed members to report "gross" short positions existing in each proprietary and customer account (rather than net positions across accounts).<sup>9</sup> Thus, 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(a) of Regulation SHO, as well as where the sale transaction that caused the short position was marked "long," consistent with SEC Regulation SHO, due to the firm's or the customer's net long position at the time of the transaction (e.g., aggregation units).

Second, FINRA has proposed to clarify 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. Therefore, 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. Of course, short interest positions resulting from short sales that reached the expected settlement date, but failed to settle (i.e., "fails"), must be included.

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option; or (e) The person has rights or warrants to subscribe to it and has exercised such rights or warrants; or (f) The person holds a security futures contract to purchase it and has received notice that the position will be physically settled and is irrevocably bound to receive the underlying security. See Rule 200(b) of SEC Regulation SHO.

<sup>9</sup> See Intermarket Surveillance Group, Consolidated Reporting of Short Interest Positions, ISG Regulatory Memorandum 95-01 (March 6, 1995).

Third, FINRA has proposed to clarify 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).<sup>10</sup> Therefore, for the purposes of short interest reporting, members must reflect corporate actions (e.g., a reverse or forward split) 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 designated by FINRA for such cycle (even if payment of the distribution is not received until after the designated reporting settlement date).

Finally, consistent with discussions with the ISG, FINRA has proposed amendments to delete certain existing exceptions to the Rule.<sup>11</sup> The Rule provides five exceptions, including an exception for stabilizing activity, domestic arbitrage and international arbitrage. FINRA, in cooperation with the ISG Short Interest Working Group (“ISG Working Group”), determined that the transactions addressed in these three exceptions result in the type of short positions that would be of interest to

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<sup>10</sup> The ex-date is the date on or after which a security is traded without a specific dividend or distribution. The ex-date also is the date that DTCC uses to determine who is entitled to the distribution. The payable date is the date that the dividend is sent to the record owner of the security. See e.g., Regulatory Notice 00-54 (August 2000).

<sup>11</sup> FINRA has worked closely with other SRO members of the ISG, a group that includes representatives of every U.S. SRO, to address problems that reach across marketplaces. Each ISG member adopted consistent short-interest reporting rules to enhance surveillance capabilities, augment market transparency, enable investors to make more informed decisions, and provide greater disclosure for regulatory purposes.

regulators and the public, and therefore, determined that these exceptions no longer are appropriate.<sup>12</sup>

FINRA has stated that it believes that the proposed amendments will remove confusion regarding the operation of the Rule and help facilitate the availability to the public and regulators of accurate and complete short interest information.

FINRA has represented that it will announce the effective date of the proposed rule change in a Regulatory Notice to be published no later than 120 days following Commission approval. FINRA has also represented that the effective date will be no more than 365 days following Commission approval.

### III. Summary of Comments and FINRA's Response

In the SIFMA Letter, the commenter generally supports the proposal but raised concerns with one aspect of the proposal. In the SIFMA Letter, the commenter also recommends other changes to the existing short interest reporting requirements. First, the commenter supports (1) the reporting of short positions based on gross short positions in all customer and proprietary accounts, (2) the deletion of certain existing exceptions to short interest reporting for stabilizing activity, domestic arbitrage and international arbitrage, and (3) the reporting of short positions that have settled or reached settlement date by the close of the reporting settlement date designated by FINRA. The commenter,

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<sup>12</sup> FINRA and the ISG Working Group determined that the remaining two exceptions continue to be appropriate. Specifically, the exception for sales for an account in which the person has an interest, owns the security and intends to deliver it as soon as is possible (which FINRA is retaining) is intended to address circumstances where there may be a brief delay in delivery but the sale is a long sale, *i.e.*, exercise of a right, option, or warrant. In addition, the over-allotment exception (which FINRA also is retaining) addresses the narrow circumstance where the underwriter has not received shares and results in a short position for a very brief duration.

however, opposes the proposed requirement that short interest reports reflect corporate actions adjusted as of the ex-date of the corporate action (and if no ex-date is declared by an SRO, then the payment date of a corporate action). The commenter argues that such requirement is inconsistent with other proposed requirements, is inconsistent with how firms maintain their stock records and how firms' systems capture short interest position information, and would require extensive programming at significant cost.

In the Response Letter, FINRA stated that it would amend the proposed rule change to delete the adjustment of corporate actions aspect of the proposal to provide FINRA additional time to gather further information on the issue and formulate a regulatory approach. FINRA also stated that it would separately amend Rule 4560 at a future date to propose a uniform requirement regarding the adjustment of corporate actions for short interest reporting purposes.

Additionally, in the SIFMA Letter, the commenter recommends changes to the existing short interest reporting requirements, including narrowing the exception from the reporting requirements for "owned" securities. FINRA declined to amend the proposal to make the requested changes suggested by SIFMA. In the Response Letter, FINRA stated that the additional comments raised by SIFMA relate to existing requirements of the Rule and not the current proposal. FINRA noted that SIFMA's recommendations are not germane to the consideration of the merits of the proposal or relevant to whether the proposal is consistent with the Exchange Act.

#### IV. Discussion and Commission's Findings

After careful review of the proposed rule change, the comments received and FINRA's Response Letter and the Amendments, the Commission finds that the proposed

rule change, as modified by the Amendments, is consistent with the requirements of the Act, and the rules and regulations thereunder that are applicable to a national securities association.<sup>13</sup> In particular, the Commission believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act, in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest. More specifically, the Commission believes that the proposed rule change to amend FINRA Rule 4560 will promote consistency and accuracy in the calculation and reporting of short interest positions by members. The Commission believes that FINRA has adequately responded to the concerns the SIFMA Letter. In response to SIFMA's comments concerning the adjustment of corporate actions for short interest reporting purposes, FINRA amended its proposal to delete this aspect of the proposal in order to allow additional time to gather further information. In addition, FINRA has suitably explained its reasons for declining to amend the proposed rule change by making the additional changes recommended by SIFMA.

V. Accelerated Approval

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<sup>13</sup> In approving the proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

The Commission finds good cause, pursuant to Section 19(b)(2) of the Act<sup>14</sup> for approving the proposed rule change, as modified by the Amendments, prior to the 30<sup>th</sup> day after publication of Amendment No. 2 in the Federal Register. In response to certain concerns raised by SIFMA, FINRA proposed in Amendment No. 2 to delete the proposed requirement that short interest reports reflect corporate actions adjusted as of the ex-date of the corporate action (and if no ex-date is declared by a self-regulatory organization, then the payment date of a corporate action). FINRA proposed Amendment No. 2 to allow FINRA additional time to gather further information on the issue of adjustment of corporate actions for short interest reporting purposes. Accordingly, the Commission finds that good cause exists to approve the proposal, as modified by the Amendments, on an accelerated basis.

#### VI. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether Amendment No. 2 is consistent with the Act. Comments may be submitted by any of the following methods:

##### Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-FINRA-2012-001 on the subject line.

##### Paper Comments:

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<sup>14</sup> 15 U.S.C. 78s(b)(2).

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-FINRA-2012-001. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2012-001 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

## VII. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>15</sup> that the proposed rule change (File No. SR-FINRA-2012-001), as modified by the Amendments, be and hereby is approved on an accelerated basis.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>16</sup>

Kevin M. O'Neill  
Deputy Secretary

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<sup>15</sup> 15 U.S.C. 78s(b)(2).

<sup>16</sup> 17 CFR 200.30-3(a)(12).