NATIONAL INVESTOR RELATIONS INSTITUTE

THE CASE FOR IMPROVED DISCLOSURE OF SHORT POSITIONS

Background

The practice of short selling (i.e., the sale of a security that the seller does not own or any sale that is consummated by the delivery of a security borrowed by the seller) has long been a controversial practice. While advocates for short selling argue that it can promote market efficiency, many companies have found that some forms of short selling, particularly "naked" short selling, can facilitate illegal market manipulation to the detriment of other investors.

Small-cap issuers with thinly traded shares and companies in industry sectors (such as technology, pharmaceutical, and biotechnology) with lengthy product development cycles before becoming profitable are particularly vulnerable to short selling abuses. For instance, the lack of transparency has allowed some hedge funds to take a secret short position, file a specious challenge to a company's patent, and then profit when the company's shares fall when the patent dispute becomes public. In some cases, investors with short positions have deliberately released misleading information or tried to interfere with a company's operations to drive down its share price.

The SEC Has Ample Authority to Require Improved Short-Selling Disclosure

Congress has expressed significant concern about short selling and included several provisions in the Dodd-Frank Act to address this issue. Section 417(a)(2) of Dodd-Frank directed the SEC to conduct a study of the feasibility, benefits, and costs of requiring the reporting of short-sale positions in publicly listed securities in real time basis. While the SEC concluded that real-time reporting would not likely be cost-effective, it did acknowledge that "[m]ore precise and timely information about short selling could help the market adjust to new information faster, promoting price efficiency and hence capital formation." In addition, Section 984(b) authorized the SEC to "promulgate rules that are designed to increase the transparency of information available to brokers, dealers, and investors, with respect to the loan or borrowing of securities." Finally, Section 929X(a) of the Dodd-Frank Act amended Section 13(f) of the Exchange Act to direct the SEC to "prescribe rules providing for the *public* disclosure of the name of the issuer and the title, class, CUSIP number, aggregate amount of the number of short sales of each security, *and any additional information determined by the Commission* following the end of the reporting period," providing that "[a]t a minimum, such public disclosure shall occur every month" (emphasis added). Given that 929X(a) amended Section 13(f), it is clear that Congress intended the SEC to adopt rules to require institutional investment managers, who now publicly report their long positions each quarter as required by Section 13(f), to start reporting their short positions. Unfortunately, the SEC has failed to implement these Dodd-Frank provisions and adopt an effective disclosure regime for short-selling activities.

Growing Consensus for Improved Short-Position Reporting

In October 2015, the NYSE Group and NIRI filed a joint rulemaking petition that urged the SEC to adopt rules to require the public disclosure of short-sale activities by institutional investment managers who are subject to Schedule 13(f). In their petition, the NYSE and NIRI asked the SEC to require public disclosure on *at least a quarterly basis* with no more than a *two-week delay* before that short-position information is made public. In December 2015, Nasdaq filed its own rulemaking petition that also urged the SEC to adopt short-position disclosure rules. Since these rulemaking petitions were filed, a diverse group of public companies, including

225 Reinekers Lane, Suite 560, Alexandria, VA 22314 · Phone (703) 562-7700 · Fax (703) 562-7701 · www.NIRI.org

Freeport McMoRan, BOK Financial, and Primoris Services Corp., have written the SEC and urged adoption of a disclosure rule on short positions. The Biotechnology Innovation Organization, which represents biotech companies and research organizations, also has called for the public disclosure of short selling.

In a May 2016 NIRI member survey of corporate practitioners and counselors, more than 94 percent of respondents said they "strongly agree" or "agree" that the SEC "should adopt rules to require improved short-position disclosure."

Key Points

- U.S. public companies now operate in an environment of great transparency governed by stock exchange rules and federal and state regulations. Unfortunately, the same level of transparency does not apply to the institutions that own the vast majority of the shares of public companies. While Congress and the SEC have accelerated various corporate deadlines (Forms 4, 8-K, 10-K, and 10-Q) to ensure that investors receive more timely information, the 13(f) reporting rules have not been updated and leave a serious gap in the regulation of short-selling. Given the advances in recordkeeping and reporting technologies in the more than 30 years since the 13(f) reporting requirements were first adopted, there is no practical reason why institutions cannot provide public disclosure of their short positions.

- Under the current 13(f) disclosure rules, hedge funds and other institutional investment managers are required only to disclose their long positions, which leads to information asymmetry and a lack of transparency that can be harmful to issuers and their investors. If both long and short investors are required to disclose their positions, all market actors, including individual investors, would have the full range of information necessary to make informed trading decisions.

- Other global markets, including the United Kingdom, France, Spain, and the European Union, have adopted rules that require individual institutions to report net short positions to regulators and to the public.

- Short-selling abuses drive down the value of growing companies and leave them with less capital for hiring employees, investing in R&D, or providing dividends to investors.

- Requiring the disclosure of short positions would help prevent market manipulation and other abusive trading practices. Transparency is the best way to combat these trading behaviors – a disclosure regime for short sellers would shine light on the motivations of these short investors and provide valuable information to issuers and the public. A short disclosure rule would greatly help the SEC, which has limited enforcement resources, police market abuses and other fraudulent conduct.

- Public disclosure of short-sale activity would help public companies better analyze market movements in their securities. Many companies currently utilize the aggregate short-sale data provided by the exchanges to evaluate the market and anticipate developments with respect to their securities (including potentially malicious rumors and false news). However, companies don't know who is shorting their shares and thus are unable to engage in a dialogue with short sellers unless they choose to surface publicly.

We encourage public companies to write comment letters that urge the SEC to draft a rule to require hedge funds and other 13(f) institutions to disclose their short positions. Once a rule is proposed, institutional investors, public companies, and other market participants could offer their views on how this regulation should be revised to address any concerns while still carrying out the SEC's mission to protect investors; maintain fair,

orderly, and efficient markets; and facilitate capital formation.

Resources on Short-Selling Disclosure

NYSE Group-NIRI, "Petition for Rulemaking Pursuant to Sections 10 and 13(f) of the Securities Exchange Act of 1934," October 2015.

Nasdaq, "Petition for Rulemaking to Require Disclosure of Short Positions in Parity with Required Disclosure of Long Positions," December 2015.

Biotechnology Innovation Organization, "Comment Letter on Request to Require Disclosure of Short Positions in Parity With Required Disclosure of Long Positions," March 2016.

225 Reinekers Lane, Suite 560, Alexandria, VA 22314 · Phone (703) 562-7700 · Fax (703) 562-7701 · www.NIRI.org