

November 8, 2023

SEC Adopts Short Sale Disclosure Rule

Rule 13f-2 Requires Institutional Investment Managers to Confidentially Report Short Position Data; the SEC Will Publicly Disclose Aggregated Information on a Delayed Basis

SUMMARY

On October 13, 2023, the Securities and Exchange Commission (the “SEC”) adopted a [new rule](#) (“Final Rule”) under the Securities Exchange Act of 1934 (the “Exchange Act”) requiring institutional investment managers (“Managers”) that meet certain thresholds for short position and short activity data on a monthly basis to report to the SEC on new Form SHO.¹ Rule 13f-2 requires a Manager to file a Form SHO within 14 days of the calendar month end regarding each equity security over which the Manager (or any person under the Manager’s control) has investment discretion with respect to a gross short position that meets or exceeds the Final Rule’s applicable reporting threshold. Specifically, for each such equity security, the Manager must file a Form SHO with information including (i) the Manager’s end-of-month gross short position and (ii) for each individual settlement date during the calendar month, the Manager’s net activity in the reported equity security. Each Form SHO will be accorded confidential treatment; however, the SEC plans to publish certain aggregated short sale related data with a one-month delay.

The SEC also adopted an amendment to the National Market System Plan (the “CAT NMS Plan”) governing the consolidated audit trail (“CAT”) requiring CAT reporting firms to report to the CAT, for the original receipt or origination of an order to sell an equity security, whether the order is a short sale effected by a market maker in connection with bona fide market making (“BFMM”) activities in the equity security for which the BFMM exception in Regulation SHO is claimed.² The SEC also provides interpretative guidance on the scope of the “narrow” BFMM exception.

Rule 13f-2, Form SHO and the amendment to the CAT NMS Plan will become effective on January 2, 2024. The compliance date for Rule 13f-2 and Form SHO is January 2, 2025, with the SEC publishing aggregated

short sale information beginning in April 2025. The compliance date for the amendment to the CAT NMS Plan is July 2, 2025.

BACKGROUND

Section 10(a) of the Exchange Act provides the SEC with broad authority to regulate short sales of securities as necessary or appropriate in the public interest or for the protection of investors. Section 929X of the Dodd-Frank Wall Street Reform and Consumer Protection Act added Section 13(f)(2) of the Exchange Act, which requires the SEC to prescribe rules to make certain short sale data publicly available no less frequently than monthly. Pursuant to these authorities and with the aim of increasing short sale transparency, on February 25, 2022, the SEC proposed new rule 13f-2 (the “Proposed Rule”).³

The Final Rule is generally consistent with the Proposed Rule, though it departs in a number of important ways, including with respect to the Form SHO content and reporting thresholds. Notably, the SEC declined to adopt with the Final Rule the proposed addition of Rule 205 to Regulation SHO (and the associated CAT amendment), which would have required firms to include a “buy to cover” order mark in order receipts and order origination reports submitted to the CAT.

FINAL RULE

Who Must Report

Rule 13f-2 will subject “institutional investment managers” to the Final Rule’s Form SHO filing requirements. Institutional investment manager is defined as any person, other than a natural person, investing in or buying and selling securities for its own account, and any person exercising investment discretion with respect to the account of any other person. This is the same definition as the one provided in Section 13(f)(6)(A) of the Exchange Act, and “investment discretion” has the same meaning as that provided in Section 3(a)(35) of the Exchange Act. Thus, the Final Rule covers all persons currently required to file reports on Schedule 13F and the Final Rule uses the same standard of investment discretion as used for purposes of Schedule 13F filings.

Similar to the filings of Schedule 13F, the instructions to Form SHO provide if two or more Managers, each of which is required by Rule 13f-2 to file a Form SHO for the reporting period, exercise investment discretion with respect to the same securities, only one such Manager must report the information in its report on Form SHO. If a Manager has information that is required to be reported on Form SHO but will be reported by another Manager (or Managers), the first Manager must identify in Form SHO the other Manager(s) reporting on its behalf.

In-Scope Securities

Unlike filings on Schedule 13F that apply only to the SEC’s official list of Schedule 13F securities, Managers must file Form SHO reports with respect to “equity securities” when certain thresholds (described below)

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are met. For purposes of Rule 13f-2, the term equity securities has the same definition as provided in Section 3(a)(11) of the Exchange Act and Rule 3a11-1 thereunder.⁴ The SEC notes that this definition makes the scope of Rule 13f-2 consistent with that of Rule 200(a) of Regulation SHO, and covers equity securities of both private and public companies. This is a very significant expansion of the securities currently reported on Schedule 13F, and encompasses even private companies that are not required to make filings with the SEC.

Securities Not Subject to Reporting

The SEC makes clear in the Adopting Release that fixed income securities, options⁵ and security-based swaps⁶ are not subject to reporting on Form SHO.

Rights, Warrants and Convertible Securities

Rule 3a11-1 would treat rights, warrants and convertible securities as “equity securities” if the investment is convertible or exchangeable for an equity security. Nevertheless, the SEC indicates that these will not be separately reportable, but that exercises or conversions of these positions will be reportable to the extent they change the net short position reported on Form SHO. These reporting requirements are described below under “Form SHO Report Content.”

Reporting Thresholds

Managers must file Form SHO reports with the SEC (via EDGAR) within 14 calendar days after the end of each calendar month if either of the following thresholds (together, the “Reporting Thresholds”) is met:

- Threshold A: with regard to each equity security that is of a class of securities that is registered pursuant to Section 12 of the Exchange Act or for which the issuer of that class of securities is required to file reports pursuant to Section 15(d) of the Exchange Act (a “reporting company issuer”), if the Manager (and all accounts over which the Manager or any person under the Manager’s control has investment discretion) either:
 - (1) has a monthly average gross short position at the close of regular trading hours in the equity security with a U.S. dollar value of \$10 million or more; or
 - (2) has a monthly average gross short position at the close of regular trading hours as a percentage of shares outstanding in the equity security of 2.5 percent or more.
- Threshold B: with regard to each equity security that is of a class of securities of an issuer that is not a reporting company issuer (a “non-reporting company issuer”), when the Manager (and all accounts over which the Manager or any person under the Manager’s control has investment discretion) has a gross short position in the equity security with a U.S. dollar value of \$500,000 or more at the close of regular trading hours on any settlement date during the calendar month.

For purposes of the Final Rule, “gross short position” means the number of shares of the equity security that are held short as a result of short sales (as defined in Rule 200(a) or Regulation SHO), without inclusion of any offsetting economic positions such as shares of the equity security or derivatives of such equity security. Thus, if a Manager has investment discretion over multiple accounts, some of which are long an

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equity security and some of which are short the same equity security, the long position would not reduce the gross short position.

To determine whether the dollar value threshold described in (1) of Threshold A above is met, a Manager must determine its gross short position at the close of “regular trading hours” in each equity security on each settlement date during the calendar month and multiply that figure by the closing price at the close of regular trading hours on the settlement date (“end-of-day dollar value”). The Manager must then add all end-of-day dollar values during the calendar month and divide that sum by the number of settlement dates in the month to arrive at a monthly average for each equity security the Manager traded during that calendar month reporting period.

To determine whether the percentage threshold described in (2) of Threshold A above is met, the Manager must:

- determine its gross short position at the close of regular trading hours in the equity security on each settlement date during the calendar month, and divide that figure by the number of shares outstanding in such security at the close of regular trading hours on the settlement date; and
- add up the daily percentages during the calendar month as determined pursuant to the preceding bullet and divide that sum by the number of settlement dates in the month to arrive at a “monthly average” for each equity security the Manager traded during that calendar month reporting period.

The number of shares outstanding of the security for which information is being reported must be determined by reference to an issuer’s most recent annual or quarterly report, and any subsequent update thereto, filed with the SEC.

To determine whether the dollar value threshold described in Threshold B above is met, a Manager must determine its gross short position at the close of regular trading hours in the equity security on each settlement date during the calendar month and multiply that figure by the closing price at the close of regular trading hours on the settlement date. If such closing price is not available, a Manager must use the price at which it last purchased or sold any share of that security.

Form SHO Report Content

When a Reporting Threshold is met with respect to any equity security, a Manager is required to file a Form SHO with information aggregated across accounts over which the Manager, or any person under the Manager’s control, has investment discretion. Form SHO consists of two parts: (1) the Cover Page and (2) the two Information Tables.

Each Form SHO Cover Page must include the following information:

- the period end date (*i.e.*, last settlement day of the calendar month);
- whether the filing is an amendment and restatement (and if so, the Manager must provide a description of the revision, explain the reason for the revision and indicate whether data from any additional Form SHO reporting periods (up to the past 12 calendar months), if any, are affected);⁷

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- certain basic information about the Manager, including its name, mailing address, telephone number, email address, non-lapsed Legal Entity Identifier (“LEI”) and contact employee; and
- designation of the report type.⁸

Information Table 1 requires reporting of information on a Manager’s gross short position, including:

- the settlement date (*i.e.*, the last day of the calendar month of the reporting period on which a trade settles);
- the name of the issuer of the security;
- the issuer’s LEI;
- the title of the class of the security;
- the security’s CUSIP number;
- the security’s financial instrument global identifier (“FIGI”), if one has been assigned;
- the number of shares that represent the Manager’s gross short position in the security at the close of regular trading hours on the last settlement date of the calendar month of the reporting period; and
- the U.S. dollar value of the shares reported pursuant to the preceding bullet, rounded to the nearest dollar.⁹

The SEC did not adopt the Proposed Rule’s requirement that Managers would have to indicate whether the identified gross short position was “fully hedged,” “partially hedged” or “not hedged,” noting significant implementation challenges.

Information Table 2 requires reporting of information on the daily activity affecting a Manager’s gross short position during the reporting period, including:

- the settlement date;
- the name of the issuer of the security;
- the issuer’s LEI;
- the title of the class of the security;
- the security’s CUSIP number;
- the security’s FIGI, if one has been assigned; and
- the net change in short position (represented as a number of shares).

With respect to the net change in short position, the Form SHO instructions provide that a Manager must enter the net change in short position (represented as a number of shares) reflecting how the reported gross short position in shares of the security for which information is being reported are being closed out—or increased—as a result of the acquisition or sale of shares of that equity security, by taking into account:

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- short sales of the security that settled on that date;
- shares of the security that were purchased to cover, in whole or in part, an existing short position and settled on that date;
- shares of the security that were acquired in a call option exercise that reduces or closes a short position on that security and settled on that date;
- shares of the security that were sold in a put option exercise that creates or increases a short position on that security and settled on that date;
- shares of the security that were sold in a call option assignment that creates or increases a short position on that security and settled on that date;
- shares of the security that were acquired in a put option assignment that reduces or closes a short position on that security and settled on that date;¹⁰
- shares of the security for which information is being reported that were acquired as a result of the tendered conversions that reduces or closes a short position on that security and settled on that date;
- shares of the security that were obtained through a secondary offering transaction that reduces or closes a short position on that security and settled on that date. Such secondary offering purchases must be reported whether they occurred outside or within the restricted period of Rule 105 of Regulation M;
- shares of the security that resulted from other activity not previously reported on this form that creates or increases a short position on that security and settled on that date, or that reduces or closes a short position on that security and settled on that date; and
- any other activity that creates or increases, or reduces or closes, a short position on that security, including, but not limited to, shares resulting from ETF creation or redemption activity.

The Proposed Rule would have required the information set out in the immediately preceding bullets above to be reported in separate columns within Information Table 2. The approach adopted in the Final Rule instead requires Managers to report only the net change in short position based on these inputs as calculated by the Manager.

With respect to the Information Tables, the SEC in the Form SHO instructions states that Managers must account for a gross short position in an ETF, and activity that results from the creation and redemption of ETFs. In determining its gross short position in an equity security, however, a Manager is not required to consider short positions that the ETF holds in individual underlying equity securities that are part of the ETF basket.

SEC Publication of Short Sale Data

Information filed with the SEC on Form SHO is deemed subject to a confidential treatment request under SEC Rule 83. However, the SEC “currently plans” to publish the following information within one month after the end of the reporting calendar month:

- with regard to Information Table 1, for each class of equity securities, as an aggregated number of shares across all reporting Managers, the number of shares of the reported equity security that represent the Managers’ gross short position at the close of the last settlement date of the calendar

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month, as well as the corresponding aggregated U.S. dollar value of this reported gross short position; and

- with regard to Information Table 2, for each reported equity security, for each individual settlement date during the calendar month, the net activity in the reported equity security, as aggregated across all reporting Managers.

The SEC rejected comments that recommended publication of information at the individual Manager level and requests that the SEC verify Form SHO data before making it public (the SEC noted that Managers are responsible for the accuracy of such reports and that the SEC may conduct examinations and bring enforcement actions as necessary to ensure compliance).

Cross-Border Application

In response to commenters' requests to narrow the category of securities subject to Rule 13f-2 (as described above), the SEC also provided its view as to the cross-border reach of the rule. Consistent with its territorial approach to regulation, the SEC stated that "the relevant domestic conduct under section 13(f)(2) is being an institutional investment manager operating in the U.S. securities markets such that the investment manager is subject to filing reports with the [SEC]." Therefore, "when that relevant domestic conduct is present here in the United States, section 13(f)(2)'s regulatory reporting obligation will generally apply."

CAT NMS Plan Amendment

The SEC adopted an amendment to the CAT NMS Plan that will require broker-dealers to indicate if an order is a short sale effected by a market maker in connection with BFMM activities for which the Regulation SHO Rule 203 BFMM locate exception is claimed. However, the SEC did not adopt proposed Rule 205 of Regulation SHO, which would have required reporting to the CAT of "buy to cover" order marking.

In response to commenters that requested additional guidance regarding the scope of BFMM activity eligible for the locate exception, the SEC stated that "the primary requirement" is that a broker-dealer that is a market maker provide widely accessible, continuous quotations at or near the market for which it is at risk. The SEC also reiterated its Regulation SHO guidance that:

- a market maker engaged in bona fide market making is a broker-dealer that deals on a regular basis with other broker-dealers, actively buying and selling the subject security as well as regularly and continuously placing quotations in a quotation medium on both the bid and ask side of the market;
- broker-dealers that do not publish continuous quotations, or publish quotations that do not subject the broker-dealer to such risk (e.g., quotations that are not publicly accessible, are not near or at the market, or are skewed directionally towards one side of the market), would not be eligible for the BFMM exception; and
- broker-dealers that publish quotations but fill orders at different prices than those quoted would not be engaged in bona fide market making for purposes of Regulation SHO.

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The SEC also repeatedly notes in the Adopting Release that the BFMM exemption is a “narrow exemption” and that the broker-dealer must be engaged in market marking in the particular security at the time of the short sale.

IMPLICATIONS

Enhanced Systems, Policies and Procedures

The new Rules will require Managers to implement significantly enhanced systems, policies and procedures to generate the data required by Form SHO. In particular, Managers that currently report on Schedule 13F will need to adopt new systems to track positions in:

- all public reporting companies and not just those on the Schedule 13F official list;
- all private companies in which they hold positions; and
- the outstanding securities of all public companies.

This will undoubtedly be a significant undertaking that will need to commence promptly to meet the January 2, 2025 deadline as new systems will need to be both integrated into existing reporting systems and tested. The SEC’s estimate of 325 burden hours to uplift the systems of current Schedule 13F filers appears to significantly underestimate the systems work needed to be performed.

No Phase-In for New Filing Managers

The SEC has not provided a phase-in period for a Manager that for the first time is required to file reports pursuant to Form SHO. In light of the significant systems, policies and procedures that must be implemented to comply with Form SHO, Managers may need to prohibit or strictly limit the size of short positions in order to stay below the reporting thresholds. In light of the SEC’s use of gross short positions in the Reporting Thresholds, firms engaged in traditional convertible or merger arbitrage may find themselves subject to the new Rule. Likewise, firms engaged in the arbitrage between ADRs and the underlying ordinary shares or ETFs and the underlying securities may become subject to reporting.

Cross-Border Application

The SEC takes the view that Managers currently required to file Schedules 13F will also be subject to file reports on Form SHO and that is justified since the Managers are active in the U.S. securities market. The new Rule, however, unlike Schedule 13F, covers all public reporting companies and even private companies. Thus, non-U.S. Managers that invest only in non-public U.S. companies may find themselves subject to reporting on Form SHO.

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Scope of BFMM Exception

The SEC in the Adopting Release takes a “narrow” view of the BFMM exception. Broker-dealers that rely on the BFMM exception should review their policies and procedures to ensure consistency with the SEC’s view of what activity is necessary to take advantage of the exemption.

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ENDNOTES

- 1 Release No. 34-98738 (Oct. 13, 2023), available at <https://www.sec.gov/files/rules/final/2023/34-98738.pdf> (the “Adopting Release”).
- 2 Release No. 34-98739 (Oct. 13, 2023), available at <https://www.sec.gov/files/rules/other/2023/34-98739.pdf>.
- 3 Release No. 34-94313 (Feb. 25, 2022), available at <https://www.sec.gov/files/rules/proposed/2022/34-94313.pdf>; Release No. 34-94314 (Feb. 25, 2022), available at <https://www.sec.gov/files/rules/proposed/2022/34-94314.pdf>.
- 4 “Equity securities” is defined in Rule 3a11-1 as “any stock or similar security, certificate of interest or participation in any profit sharing agreement, preorganization certificate or subscription, transferable share, voting trust certificate or certificate of deposit for an equity security, limited partnership interest, interest in a joint venture, or certificate of interest in a business trust; any security future on any such security; or any security convertible, with or without consideration into such a security, or carrying any warrant or right to subscribe to or purchase such a security; or any such warrant or right; or any put, call, straddle, or other option or privilege of buying such a security from or selling such a security to another without being bound to do so.”
- 5 The SEC’s treatment of options is very unclear in the Adopting Release. In one place it notes options are subject to separate reporting and therefore are not subject to the Final Rule, but in another states that options are subject to the Final Rule. In light of the information required to be reported in Form SHO with respect to option settlements, we do not believe that options themselves need to be reported as equity securities in Form SHO.
- 6 The SEC notes in this regard its proposal to require reporting of security-based swaps pursuant to Rule 10B-1. For a discussion of proposed Rule 10B-1, see our memo to clients, *SEC Proposes Rules Relating to Security-Based Swaps* (Dec. 29, 2021), available at <https://www.sullcrom.com/insights/memo/2021/December/SEC-Proposes-Rules-Relating-to-SecurityBased-Swaps>.
- 7 In this regard, a Manager must file a separate Amended and Restated Form SHO for each calendar month affected up to 12 months. The Adopting Release states that Managers must file an Amended and Restated Form SHO within 10 calendar days of discovering the error.
- 8 According to Form SHO instructions, if all of the information that a Manager is required to report on Form SHO is reported by another Manager (or Managers), that Manager should check the box for Report Type “FORM SHO NOTICE,” include on the Cover Page the Name and non-lapsed LEI (if available) of each of the Other Managers Reporting for this Manager, and omit the Information Tables. If all of the information that a Manager is required to report on Form SHO is being reported by the Manager, the Manager should check the box for Report Type “FORM SHO ENTRIES REPORT,” omit the “Name and Non-Lapsed LEI (if available) of each of the Other Managers Reporting for this Manager” section of the Cover Page, and include the Information Tables. Finally, if only a part of the information that a Manager is required to report on Form SHO is being reported by the Manager, the Manager should check the box for Report Type “FORM SHO COMBINATION REPORT,” include on the Cover Page the name and non-lapsed LEI (if available) of each of the Other Managers Reporting for this Manager, and include the Information Tables.
- 9 The Form SHO instructions provide that “[a] Manager shall report the corresponding dollar value of the reported gross short position by multiplying the number of shares of the security for which information is being reported by the closing price at the close of regular trading hours on the last settlement date of the calendar month. In circumstances where such closing price is not available, the Manager shall use the price at which it last purchased or sold any share of that security.”
- 10 The SEC describes a “tendered conversion” as a conversion of a convertible security position where the shares received upon conversion are used to close out a short hedge position.

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