

A black and white photograph showing the silhouettes of three people in business attire standing in a hallway with large columns. They appear to be in conversation. The lighting is dramatic, with strong shadows.

There is a growing consensus among companies that the SEC should mandate the public disclosure of short positions.

The Long & Short of It

By Eileen Gannon

Betting that a company's stock price will decline by selling stock "short" is a trading strategy popular since the early 17th century. Short sellers have been implicated in nearly every bear market since then. But that doesn't make them all bad. In fact, short selling is essential to keeping public markets running today. Market makers (including specialists) and block positioners can use short interest to offset temporary

imbalances in the bid and ask for securities, thereby providing essential market liquidity and price efficiency.

The critical role that short selling plays in public markets is also why NIRI, the NYSE Group, Nasdaq, and a growing number of companies want short interests to start publicly disclosing their investment positions.

In 1975, the Securities Exchange Act of 1934 was amended to include Section 13(f), which mandated that long equity

ownership must be reported within 45 days after the close of the calendar quarter. The statutory provision remains intact after all these years, although the Dodd-Frank Act amended it slightly in 2010. However, short-selling investors who endeavor to sell high and buy low (in that order) do not have to follow the same disclosure rules as long-position holders.

"Shorting can add to efficient markets, but short sellers should have the same reporting requirements as long investors,"

says Derek Cole, president of Investor Relations Advisory Solutions, and a former chairman of NIRI's Board of Directors.

It's important to clarify the difference. Short selling occurs when a trader sells shares that he or she does not own. A trader executes a short sale by borrowing shares from a broker for a small fee with the intent to buy the stock back sometime in the future. Short selling requires minimal capital upfront and can be an easy hedge. Opposite of long investing, short selling is profitable if the stock price falls between the time it's sold and is purchased.

Short selling has recently attracted more scrutiny due to the increasing size of trades and number of companies affected. Hedge funds making billion-dollar bets draw a lot of attention. But small companies can feel the heat too. Thinly traded companies, who can benefit the most from the liquidity that short selling offers, can also suffer the most from wholesale selling when the shorts decide to exit en masse.

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 short a company's stock, file a specious challenge to a company's patent, and then profit when the company's shares fall when the patent dispute becomes public, according to the Biotechnology Innovation Organization, which represents 1,100 biotech companies and research organizations. In some cases, investors with short positions have deliberately released misleading information or even tried to interfere with a company's operations to drive down its share price. When that happens, the

opacity of short sellers can undermine investor confidence.

NIRI-NYSE Rulemaking Petition

In October 2015, NIRI and NYSE filed a joint rulemaking petition that asked the U.S. Securities and Exchange Commission (SEC) to implement provisions of the Dodd-Frank Act "to require the periodic public disclosure of short-sale activities by institutional investment managers." That petition seeks disclosure on at least a quarterly basis and with no more than a two-week delay before positions are made public. NIRI and NYSE call for broadly defining "short positions" to include not only short sales, but also derivative and similar transactions having the same economic impact.

The petition follows another NIRI-NYSE petition submitted to the SEC in February 2013 that asks for more timely disclosure of long positions under Section 13(f). Their goal is to "improve public disclosure standards and broaden the accessibility of relevant data to the investors and listed companies." That petition, which was joined by the Society of Corporate Secretaries and Governance Professionals, asks the SEC to reduce the 13(f) reporting period from 45 days to two business days after the end of a quarter.

"With the advances in technology, I also think the time period for both reporting requirements should be shortened," added Cole.

Additional Support for Reform

Since NIRI and NYSE filed their short-disclosure petition, other industry organizations have voiced similar views. In December, Nasdaq submitted its own rulemaking petition with the SEC that asks for public disclosure of short positions.

"As Congress recognized, it is incongruous that certain investors who accumu-

late long positions are required to publicly disclose their holdings, but there is no corresponding obligation for short sellers to do so, including synthetic or derivative instruments that allow an investor to profit from a loss in value of the underlying security," Nasdaq stated in its petition. "This asymmetry has several deleterious effects: it deprives companies of insights into trading activity and limits their ability to engage with investors, the market of information to ensure it functions efficiently and fairly, and investors of information to use to make meaningful investment decisions."

Nasdaq points out in its petition that 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.

A diverse group of companies, such as Freeport McMoRan, BOK Financial, GoPro, Primoris Services Corp., and PRA Group, have submitted comment letters in support of short-position reporting. In its letter, the Biotechnology Innovation Organization argues that "the current lack of transparency around short positions is enabling trading behaviors that unfairly harm growing companies and their investors."

Cole, like his former IR colleagues in the biotechnology and pharmaceutical industries, has faced tough battles with short sellers. He knows first-hand how companies can suffer from a lack of investor transparency.

"Part of the problem in the current system is that real-time, short-selling information is available, but only to a select group of people," explained Cole. These can include traders, back-office employees, the third party executing the trades, and people involved in block trades.

"If an investor is accessing public capital, then public disclosures should simply be part of the process," said Cole.

Benefits for Companies and Investors

For the most part, investors who engage in short selling do not want to report their investment activity because they want to protect proprietary trading strategies. While that's understandable, disclosure advocates point out that investors would not have to report their positions until after the close of the calendar quarter. It's not uncommon for hedge funds to hold short positions for just a few weeks.

As the NIRI-NYSE petition states, concerns about trading strategies could be addressed with appropriately designed rules that could include the use of reporting thresholds, either as a percentage of existing market capitalization, a percentage of the investor's portfolio, or as a flat value threshold. Short investors also could file confidential treatment requests with the SEC to delay their reporting, as many fund managers already do to shield their long positions.

In a June 2014 report, the staff of the SEC's Division of Corporation Finance found that real-time reporting was not feasible, but the staff conceded the benefits of increased transparency and disclosure around short-selling activity, noting that "more precise and timely information about short selling could help the market adjust to new information faster, promoting price efficiency and hence capital formation." The staff noted that "many market participants indicate an interest in more public short selling data."

Today's available data on short selling is inconsistent and can be misleading. 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, IROs don't know who is shorting their compa-

ny's shares and thus are unable to engage in a dialogue with short sellers unless they choose to publicly surface.

This lack of transparency can be costly, even to the short sellers themselves. For example, a large short interest in a company could be misunderstood to mean that broad

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investor sentiment is negative, when in fact that short interest may be in place to hedge an even larger long position.

Additional risks of cloaked information can include illegal manipulations, alleged over-voting of borrowed shares, and failure to cover “naked” or unsupported short positions. Unfortunately, the damage to companies and other investors often has been done by the time the SEC learns of suspected abuses and pursues an enforcement action.

“It’s one thing to have proprietary trading information; it’s another thing to act unethically,” Cole says.

More data, based on actual trades, can help short sellers better understand the companies they are investing in and help explain price movements and daily volume. Also, the public opinion that short sellers have an unfair advantage would go away.

“The NYSE-NIRI rulemaking petition is a good thing for both investors and issuers,” said Troy Calkins, general counsel of Workiva Inc. “Increasing the transparency around short sales would improve the ability of investors and issuers to evaluate the market in general, as well as movements in a particular stock.”


As IROs well know, executives and directors are required by SEC rules to report

stock sales within two business days, while companies are obligated by Form 8-K rules to disclose a long list of corporate developments within four days. Companies also are required to report in their quarterly filings that they intend to undertake a share repurchase program (with details such as the

estimated time period when the purchases will be made, the maximum number of shares to be acquired, and the purpose for acquiring those shares). However, the short sellers and other investors who benefit from all these disclosures do not share in this transparency.

“We need a level playing field for everyone. The benefits of closer alignment of short and long positions would offset any additional compliance burden,” said Cole.

“Additional disclosure does not have to be burdensome,” added Calkins.

“Advances in software technology can automate that reporting, and ultimately benefit all investors.” 

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For more information about short selling disclosure, including links to the NIRI-NYSE and Nasdaq rulemaking petitions, please visit the “Short Selling” page on NIRI’s website at: <https://www.niri.org/advocacy/niri-regulatory-positions/short-selling>. If your company is interested in submitting a comment letter in support of short position disclosure and would like NIRI’s assistance, please contact Ted Allen, NIRI’s director of regulatory affairs and practice resources, at tallen@niri.org.