NATIONAL INVESTOR RELATIONS INSTITUTE

The Case for Improved Disclosure of Short Positions

The National Investor Relations Institute (NIRI), whose members include 3,300 investor relations professionals who represent over 1,600 public companies and $9 trillion in stock market capitalization, is asking lawmakers to urge the Securities and Exchange Commission to adopt a short-position disclosure rule to help protect public companies and investors from short-selling abuses.

Background

The practice of short selling (or "shorting") (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" shorting, 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 published 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-Position Disclosure

In 2010, Congress expressed significant concern about short selling and included several provisions in the Dodd-Frank Act to address this issue. Most notably, Section 929X(a) of Dodd-Frank 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). 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 this Congressional mandate and adopt an effective disclosure regime for short-selling activities.

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Growing Consensus for Improved Short-Position Reporting

In 2015, NIRI, Nasdaq, and the NYSE Group filed rulemaking petitions 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). Since then, a diverse group of 15 public companies, as well as a bipartisan group of five Senate and House lawmakers, have written the SEC and urged adoption of a disclosure rule on short positions. The Biotechnology Innovation Organization, which represents biotech companies, also has weighed in support of a disclosure rule.

There is growing support throughout the U.S. capital markets for greater transparency around short positions. In both 2016 and 2017, the SEC's Government Business Forum on Small Business Capital Formation recommended the agency adopt a short-position disclosure mandate. In 2018, a coalition of eight business organizations, including the U.S. Chamber of Commerce, the National Venture Capital Association, and SIFMA, included short-position disclosure among its recommendations to improve the climate for IPOs and public companies. During a 2018 NIRI survey of corporate investor relations practitioners and counselors, 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 material information on a more timely basis, the 13(f) reporting rules have been not updated and leave a serious gap in the regulation of short-selling. Given the advances in recordkeeping technology 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.

- 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.

- 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.

- 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.

- The lack of short-position transparency runs counter to the recent efforts by investors and companies to promote more long-termism in the U.S. capital markets. When companies make their executives and directors available to speak with shareholders, they should know whether they are talking to an investor who seeks to profit from a short-term share decline or is interested in creating long-term shareholder value.

NIRI encourages lawmakers to write letters that urge the SEC to implement Section 929X of Dodd-Frank and start drafting a rule to require institutional investors to disclose their short positions. Once a rule is proposed, investors, 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.

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