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NEW SEC SHORT SALE DISCLOSURE RULE SIGNIFICANTLY EXPANDS REPORTING OBLIGATIONS FOR INSTITUTIONAL INVESTMENT MANAGERS

The U.S. Securities and Exchange Commission ("**SEC**") recently adopted new Rule 13f-2 under the Securities Exchange Act of 1934 (the "**Exchange Act**") that will require certain "institutional investment managers," which can include fund managers, as well as entities that may not on their face seem to fall within this definition, such as banks and corporations, to report detailed information to the SEC on a monthly basis regarding their short sale positions in equity securities on new Form SHO.[1]

The requirements of this new rule will need to be considered carefully by those that are required to file on Form 13F, as the scope of equity securities for which short positions must be reported on Form SHO is considerably broader than those that must be reported for purposes of Form 13F. In this briefing, we provide an overview of Rule 13f-2 and Form SHO, as well as discuss the types of equity securities that will be subject to Form SHO reporting and how they differ from those that managers must consider in relation to their Form 13F reporting.

BACKGROUND OF RULE 13F-2 AND FORM SHO

The SEC first adopted rules regarding short sales of securities in 1938; however, they were not meaningfully updated until the SEC adopted Regulation SHO, which became effective in January 2005.[2] Regulation SHO requires, among other things, broker-dealers to properly mark sale orders to identify short sales and to locate a

[1] SEC, Short Position and Short Activity Reporting by Institutional Investment Managers, Exchange Act Release No. 34-98738 (Oct. 13, 2023) ("**Adopting Release**").
[2] SEC, Short Sales, Exchange Act Release No. 50103 (July 28, 2004).

source of shares that they reasonably believe can be delivered in time for settlement before effecting a short sale, as well as trading centers to have policies and procedures in place to restrict short selling upon the occurrence of certain events. The SEC separately adopted an antifraud provision (Exchange Act Rule 10b-21) to address failure to deliver in securities associated with "naked" short selling.[3]

In 2010, Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act, Section 929X of which added Section 13(f)(2) to the Exchange Act. This provision required the SEC to "prescribe rules providing for the public disclosure 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 [SEC] following the end of the reporting period" and to make such data publicly available at least monthly.[4]

The SEC first proposed Rule 13f-2 and Form SHO in February 2022 in order to address the requirements of Section 13(f)(2) and "increase transparency" regarding short selling for both market participants and regulators.[5] While some commenters supported the proposed rule, others argued that its scope was overbroad and that the agency failed to properly articulate the benefits of the rule or accurately estimate the costs and other burdens that the rule would impose on affected parties.[6]

In response to these comments, the SEC made certain changes in the final version of Rule 13f-2 and Form SHO, including eliminating certain reporting requirements, adjusting the specific reporting thresholds, and clarifying certain language in the rule for greater comprehensibility.[7] Despite these changes, as we discuss in more detail below, the final rule remains very broad and is likely to impose meaningful costs on affected managers.

Rule 13f-2 will apply to all "institutional investment managers"[8] (hereafter referred to as "**Managers**") that hold short sale positions in equity securities that meet or exceed specified thresholds. As mentioned above, these Managers typically include brokers and dealers, investment advisers, banks, insurance companies, pension funds and corporations. Practically, however, the SEC has stated that "[r]egistered investment advisers, particularly those managing hedge funds, are the primary Managers likely to be affected by" the new rule.[9] Despite the SEC's proclamation, there remains a large category of unregistered Managers that are based outside of the United States, but operate in the U.S. securities markets (and

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3 SEC, "Naked" Short Selling Antifraud Rule, Exchange Act Release No. 58774 (Oct. 14, 2008).
4 Public Law 111-203, sec. 929X, 124 Stat. 1376, 1870 (July 21, 2010); Exchange Act Section 13(f)(2).
5 Adopting Release, *supra* note 1, at 8.
6 *Id*. at 13.
7 *Id*. at 17-19.
8 The term "institutional investment manager" in Rule 13f-2 is as defined under the Exchange Act and is the same as for purposes of Rule 13f-1 (and Form 13F required thereunder – therefore causing the requirement to file on Form 13F to effectively be the key gating issue for Managers (defined herein) when considering the potential requirements to file on Form SHO). An "institutional investment manager" includes "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*" (emphasis added). Exchange Act Section 13(f)(6)(A). The term "investment discretion" is also as defined under the Exchange Act and is the same as the definition in Rule 13f-1. Exchange Act Section 3(a)(35); Rule 13f-1(b). The SEC notes that this definition is far-reaching as it not only covers all accounts over which the Manager has investment discretion, but also all accounts over which any person under the Manager's control has discretion. Adopting Release, *supra* note 1, at 20.
9 Adopting Release, *supra* note 1, at 178.

are thus subject to U.S. reporting requirements), which are also in scope[10] and will need to determine whether they are required to make Form SHO filings following the Compliance Date (defined below).

REPORTING THRESHOLDS

Rule 13f-2 requires a Manager to determine each month whether it is required to file Form SHO on the basis of meeting or exceeding the applicable threshold(s) specified in the rule with respect to any equity security. If the Manager meets or exceeds the applicable threshold(s), it must file Form SHO with the SEC within 14 calendar days after the end of the month in which the threshold was met or exceeded.

As detailed below, the short position thresholds depend on the type of issuer of the equity security (*i.e.,* whether the issuer is a reporting (public) or non-reporting (private) company). Specifically, the thresholds requiring a Form SHO to be filed are:

Equity securities of reporting companies[11]

The Manager[12] has either (i) a monthly average gross short position[13] in shares of the company with a value of US$10 million or more at the close of regular trading hours during the calendar month or (ii) a monthly average gross short position equal to or greater than 2.5% of the outstanding shares of such company.

- Managers must determine the dollar value of their short position for purposes of threshold (i) by multiplying their gross short position at the close of regular trading hours in the security on each settlement date during the calendar month by the closing price at the close of regular trading hours on the settlement date (or, if such closing price is not available, the price at which the Manager last purchased or sold any share of that security). The Manager must then add all end of day dollar values during the month and divide that sum by the number of settlement dates to obtain the “monthly average.”
- Managers must determine the percentage of their short position for purposes of threshold (ii) by (1) adding each daily percentage during calendar month (calculated as the gross short position at the close of regular trading hours in the security on each settlement date during the calendar month divided by the number of shares outstanding in such security at the close of regular trading hours on the settlement date[14]) and (2) dividing that by the number of settlement dates in the month to obtain the “monthly average.”

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[10] *See id.* at 35-36.
[11] “Reporting companies” are issuers that issue a class of securities registered pursuant to Section 12 of the Exchange Act or for which the issuer is required to file reports pursuant to Section 15(d) thereof.
[12] Note that the Manager must not only count its own positions and the positions of all accounts over which it has investment discretion, but also positions held by all accounts over which any person *under the Manager’s control* has investment discretion.
[13] The rule defines a “gross short position” to mean the number of shares of the equity security that are held short as a result of short sales (as defined in Regulation SHO) without inclusion of any offsetting economic positions (such as shares or derivatives of the equity security). Rule 13f-2(b)(4).
[14] The number of shares outstanding is determined by referencing the issuer’s most recent annual or quarterly report (and any subsequent update thereto) filed with the SEC. *See* Form SHO.

Equity securities of non-reporting companies

The Manager has a gross short position with a value of US$500,000 or more at the close of regular trading hours on any settlement date during the calendar month.

- Managers must determine the dollar value of their short position by determining their short position at the close of regular trading hours in the security on each settlement date during the calendar month and multiplying that figure by the closing price at the close of regular trading hours on the settlement date (or, if such closing price is not available, the price at which the Manager last purchased or sold any share of that security).

In order to compute the above thresholds, Managers will need to monitor and capture their positions daily in order to determine whether they have a filing obligation.

SCOPE OF EQUITY SECURITIES

Rule 13f-2 covers short sales of "equity securities," as defined in Section 3(a)(11) of the Exchange Act and Rule 3a11-1 thereunder. This includes both exchange-listed and OTC equity securities.[15] The definition captures ETFs, as well as certain derivatives, options, warrants and convertibles that are themselves equity securities. The SEC opted not to exclude securities of non-reporting company issuers despite acknowledging that information on such issuers "will be more difficult to obtain and more costly to report" for Managers.[16] Moreover, in contrast to long position reporting requirements on Form 13F, **the SEC declined to limit the scope of short position reporting only to equity securities of U.S. issuers.** Therefore, Managers will need to account for short positions in non-U.S. traded securities[17] and, because the dollar value-based thresholds are measured in U.S. dollars, will also need to consider applicable FX rates.

The scope of securities that a Manager must consider for purposes of Rule 13f-2 and Form SHO is therefore significantly more expansive than what Managers must consider for purposes of Rule 13f-1 and Form 13F. While Rule 13f-1 is focused only on reporting of long positions with respect to those Section 13(f) securities that are included on the SEC's quarterly published list of 13F securities (the "**13F List**"), the SEC decided against adopting a similar approach of creating a specific list of securities subject to short position reporting for purposes of Rule 13f-2.[18] The SEC also declined to limit those securities covered by Rule 13f-2 to those on the 13F List on the basis that market participants are already used to complying with Regulation SHO with respect to equity securities generally and that narrowing the scope of securities to the 13F List would exclude certain equity securities otherwise subject to Regulation SHO.[19]

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15 The SEC did, however, explicitly exclude fixed income securities on the basis that they are not subject to Regulation SHO. Adopting Release, *supra* note 1, at 27-28.

16 *Id*. at 34.

17 *Id*. at 35-36.

18 *Id*. at 30-31.

19 *Id*. at 32.

FORM SHO REQUIREMENTS

Form SHO (similar to Form PF) is a confidential form and will not be available to the public. However, the SEC will periodically publish aggregated data for each equity security that is derived from data reported on Form SHO.

Form SHO contains two parts: the cover page and information tables.

<u>Cover Page:</u> This includes certain identifying information about the Manager(s) filing the Form SHO report[20], as well as the type of filing (*i.e.*, an initial filing or an amendment and restatement).

<u>Table 1:</u> This includes, for each relevant equity security, the Manager's gross short position (both in number of shares and USD) at the end of the month.

<u>Table 2:</u> This includes, for each relevant equity security, the net change in the Manager's short position for each trading day of the month.

Both tables require a Manager to report the settlement date, issuer name and non-lapsed legal entity identifier (LEI) (if available), title of class, CUSIP number and a Financial Instrument Global Identifier (FIGI) (if assigned).

If a Manager determines after filing that it has reported incorrect information on its Form SHO, it must file an amended and restated Form SHO within ten calendar days of discovering the error.

COMPLIANCE DATE

Managers will need to comply with the Rule 13f-2 reporting requirements beginning on January 2, 2025 (the "**Compliance Date**"). Prior to the Compliance Date, particularly given the expanded scope of equity securities subject to the rule, Managers should ensure that their systems and processes are updated to adequately monitor and capture short sale positions that will need to be accounted for in determining whether the Manager has a Form SHO filing obligation.

We encourage you to reach out to us with any questions regarding the rule and compliance with its new requirements.

[20] As with Form 13F, to prevent duplicative reporting, if two or more Managers that are required to report on Form SHO exercise investment discretion with respect to the same securities, only one such Manager must report the information in its Form SHO, but the non-reporting Managers must make notice filings identifying the Manager reporting on their behalf.

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