23-60626

IN THE

FOR THE FIFTH CIRCUIT

NATIONAL ASSOCIATION OF PRIVATE FUND MANAGERS;
MANAGED FUNDS ASSOCIATION;
ALTERNATIVE INVESTMENT MANAGEMENT ASSOCIATION,

Petitioners,

—v.—

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

ON PETITION FOR REVIEW OF ORDERS OF
THE SECURITIES AND EXCHANGE COMMISSION

BRIEF FOR *AMICUS CURIAE*
COMMITTEE ON CAPITAL MARKETS REGULATION
IN SUPPORT OF PETITIONERS

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CORPORATE DISCLOSURE STATEMENT

Pursuant to Federal Rules of Appellate Procedure 26.1, *amicus curiae*, the Committee on Capital Markets Regulation, states that it is a not-for-profit association and has no parent corporations, subsidiaries, or affiliates. No publicly held corporation owns ten percent or more of its stock.

Dated: March 12, 2024

Washington, D.C.

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SUPPLEMENTAL STATEMENT OF INTERESTED PARTIES

Pursuant to Fifth Circuit Rule 29.2, counsel for *amicus curiae* certifies that, in addition to the interested parties identified by Petitioners in their opening brief, the following listed persons and entities have an interest in the outcome of this case. These representations are made so that the judges of this Court may evaluate possible disqualification or recusal.

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INTEREST OF AMICUS CURIAE[1]

Founded in 2006, the Committee on Capital Markets Regulation (the "Committee") is dedicated to enhancing the competitiveness of U.S. capital markets and ensuring the stability of the U.S. financial system. The Committee is an independent and nonpartisan 501(c)(3) research organization, financed by contributions from individuals, foundations, and corporations.

The Committee believes that the short selling of securities is a critically important financial market practice that provides significant benefits to the U.S. capital markets and economy. With approximately 50% of stock market trading volume constituting a short sale, short selling factors prominently in the functioning of equity markets. *See* Short Position and Short Activity Reporting of Institutional Managers, 88 Fed. Reg. 75,100, 75,151 (Nov. 1, 2023) (to be codified at 17 C.F.R. pts. 240 & 249).

Short selling promotes strong corporate governance in publicly listed U.S. companies and enhances overall market quality by improving both liquidity and price discovery in the stock market. The benefits of short selling also extend to the real economy by enhancing managerial decision making and lowering the cost of

[1] The parties have consented to this filing. No party's counsel authored this brief in whole or part, and no one other than the Committee, its members, or counsel contributed money for the brief's preparation or submission.

capital for U.S.-listed companies. Since short selling transactions often involve a securities loan, securities lending similarly contributes to the functioning of U.S. capital markets and the real economy.

INTRODUCTION AND SUMMARY OF ARGUMENT

On October 13, 2023, the Securities and Exchange Commission (the "SEC") promulgated two new rules under the Securities and Exchange Act of 1934, 15 U.S.C. § 78a *et seq*. (the "Exchange Act"), and the Dodd-Frank Wall Street Reform and Consumer Protection Act, 124 Stat. 1376 (2010) (the "DFA"), set forth in Reporting of Securities Loans, 88 Fed. Reg. 75,644 (Nov. 1, 2023) (to be codified at 17 C.F.R. pt. 240) [hereinafter, the "Securities Lending Rule"], and Short Position and Short Activity Reporting of Institutional Managers, 88 Fed. Reg. 75,100 (Nov. 1, 2023) (to be codified at 17 C.F.R. pts. 240 & 249) [hereinafter, the "Short Selling Rule"].

The Short Selling Rule and the Securities Lending Rule effectively regulate the same financial market activity albeit in a materially contradictory manner that will have severe economic consequences. In the Short Selling Rule, the SEC acknowledges the damage that the disclosure of short positions can impose on U.S. capital markets and tailors the rule accordingly by aggregating the data and delaying public release by one month. *See*, *e.g.*, 88 Fed. Reg. at 75,132-33. However, the SEC disregards and contradicts that approach in the Securities Lending Rule, effectively mandating daily disclosure of individual short positions, despite recognizing the errors of that approach in the Short Selling Rule. The fact that both rules stand in such obvious conflict and were finalized *on the same day* makes them clearly

arbitrary and capricious under Section 706 the Administrative Procedure Act (the "APA"). 5 U.S.C. § 706(2).

The SEC has also failed to conduct an adequate cost-benefit analysis ("CBA") – as it is required to do by statute, 15 U.S.C. § 77b(b) – with respect to the Securities Lending Rule, which lacks analysis of the unprecedented costs that will be imposed on the practice of short selling and the resulting damage to the efficient functioning of U.S. capital markets. The detailed disclosures mandated under the Securities Lending Rule will allow other market participants to identify individual short selling positions on a *daily* basis. The SEC's failed attempt to mitigate the problems associated with daily disclosure by delaying one specific loan detail, *i.e.*, loan amount, by 20 business days is wholly ineffective. The remaining daily disclosures are more than sufficient for other market participants to identify short positions. The Securities Lending Rules' CBA also fails even to consider whether the 20-business day delay of disclosing the loan amount would be sufficient to address the problems associated with daily disclosure. This failure is yet another reason that the Court must invalidate both the Short Selling Rule and Securities Lending Rule as arbitrary and capricious.

Finally, the SEC should not be permitted to evade adequate consideration of the interactions between the two rules based on procedural semantics. In finalizing the Securities Lending Rule, the SEC claimed that the Short Selling Rule had not yet

been adopted and therefore that the effects of the Short Selling Rule need not be considered in analyzing the costs and benefits of the Securities Lending Rule. 88 Fed. Reg. at 75,694-75,695 and n.725. However, the Short Selling Rule was adopted mere *minutes* after the Securities Lending Rule. U.S. Sec. & Exch. Comm'n, *2023 10 13 Open Meeting*, YouTube (Oct. 13, 2023), *available at* youtube.com/watch?v=NVRu8eBHkGo. Thus, the SEC has sought to avoid considering the substantive difference in the economic analysis of the rules by virtue of a *de minimis* lag in adoption. Allowing such a procedural scheme would set a troubling precedent as a means for the SEC to avoid the procedural safeguards set forth in the securities laws and the APA.

ARGUMENT

I. Short selling is vital to U.S. capital markets.

Short selling plays a fundamental role in the efficient functioning of U.S. financial markets, benefiting not only financial market participants but also the real economy. A short sale involves the sale of a security that is not owned by the seller. The short seller borrows the security through a securities lending transaction to deliver to the buyer. The short seller profits if the price subsequently drops, since the security can be purchased at a lower price to repay the securities loan. Therefore, since the short position profits when the price of the security falls, a short selling strategy represents a pessimistic view of the stock and a belief that prices will

decline. Because of the inherent pessimism involved in their strategies, short sellers have often been criticized as purely speculative traders who destabilize markets and exacerbate market downturns. *See, e.g.,* Kinsey Grant*, NYSE President Tom Farley Blasts Short Sellers, Call Them 'Un-American' and 'Icky',* TheStreet (Jun. 27, 2017, 5:41 PM), *available at* tinyurl.com/yvmcbvbm; Bill Saporito, *Are Short Sellers to Blame for the Financial Crisis?, Time* (Sept. 18, 2008)*, available at* tinyurl.com/zhznjn2j. To some, profiting from the poor performance of a public company's stock does not intuitively seem to be a socially valuable activity.

Despite the negative characterization of short selling, however, the body of empirical academic research presents a convincingly positive picture of the practice.[2] Indeed, short selling is well established as a vital financial market activity that confers several benefits to U.S. capital markets and the economy.

(i) Short selling improves corporate governance.

Short selling strengthens corporate governance for publicly listed U.S. firms by serving as an external disciplinary mechanism on firm management. In their search for overpriced stocks, short sellers are motivated to uncover wrongdoing by management and then trade on that negative information through short sales. Because of this, short sellers help to increase the probability that corporate

[2] For a survey of the academic literature on short selling, *see* Haiyan Jiang *et al*., *Short Selling: A Review of the Literature and Implications for Future Research*, 31 Eur. Acct. Rev. 1 (2022).

misconduct is discovered and the speed with which it is signaled to the market. *See* Massimo Massa *et al.*, *The Invisible Hand of Short Selling: Does Short Selling Discipline Earnings Management?*, 28 Rev. Fin. Stud. 1701 (2015). Since firm management understands that short sellers engage in this detailed monitoring of corporate behavior, management has an incentive *not* to engage in such misconduct, thus improving overall governance.

Empirical academic research demonstrates that higher volumes of potential short selling activity reduce the likelihood that firm management will fraudulently manipulate corporate earnings. *Id.* Moreover, as short selling activity has experienced an upward trend, the beneficial disciplinary impact of short selling has become more significant. *Id.* All investors in the U.S. stock market benefit from this external monitoring of corporate behavior.

Short selling also improves corporate governance through the monitoring of mergers and acquisitions ("M&A") activity. Public companies often face a corporate governance problem from the so-called "empire building" activities of senior management. *See*, *e.g.*, Nickolay Gantchev *et al.*, *Activism and Empire Building*, 138 J. Fin. Econ. 526 (2020). In these cases, management engages in potentially wasteful M&A transactions motivated primarily by a desire to lead an ever-larger corporate conglomerate rather than act in the best interests of the firm. *Id.* These actions may benefit management individually but can significantly erode shareholder value. The

disciplinary effect of short selling helps to curb wasteful M&A activity, as management is less likely to engage in such value-destroying transactions out of fear of a short selling campaign. The increased prevalence of short-selling potential has been documented to result in higher returns for M&A activity, which is indicative of greater promotion of shareholder value and less wasteful activity than would occur otherwise. Eric C. Chang *et al*., *Does Short-Selling Threat Discipline Managers in Mergers and Acquisitions Decisions?*, 68 J. Acct. & Econ. 101223 (2019).

(ii) Short selling helps maintain efficient prices.

Short selling contributes to the accuracy and efficiency of U.S. stock prices, primarily by ensuring that public information is promptly reflected in prices. Short sellers contribute to price efficiency by selling when the stock price is too high relative to the fundamental value. As the short seller puts selling pressure on a stock, the price drops into closer alignment with the fundamental value. In this way, the short seller corrects the stock's mispricing and improves price efficiency.

Importantly, short selling greatly expands the universe of informed investors who can express their views about a stock. On the buy side, investors can incorporate *positive* views into the stock price though purchasing a stock, regardless of whether they already hold a position in the stock. Short selling allows the same with respect

to *negative* views, since any investor can express a view of the stock, whether the investor already owns it or not.

Empirical research widely supports the price efficiency benefit of short selling. *See, e.g.*, Ekkehart Boehmer & Juan (Julie) Wu, *Short Selling and the Price Discovery Process*, 26 Rev. Fin. Stud. 287 (2013); Ekkehart Boehmer *et al*., *Shackling Short Sellers: The 2008 Shorting Ban*, 26 Rev. Fin. Stud. 1363 (2013); Pedro A. C. Saffi & Kari Siggurdson, *Price Efficiency and Short Selling*, 24 Rev. Fin. Stud. 821 (2011). In general, academic models of short sellers consider them rational, informed traders with "value-relevant information," *see*, *e.g.*, Boehmer & Wu, *supra*, whose trading helps incorporate that information into stock prices. Higher volumes of short selling activity in U.S. stock markets lead to lower mispricing and allow for faster incorporation of public information into the stock price. *Id.* Moreover, short selling is particularly beneficial to price efficiency on the most volatile trading days. *Id.* Notably, the SEC expressly acknowledged these empirical findings in the Short Selling Rule, *see, e.g.*, 88 Fed. Reg. at 75,163 n.625, but ignored them in the Securities Lending Rule.

All stock market investors benefit from improved price efficiency. Efficient prices reflect all available information about a firm, thus allowing investors to make informed investment decisions based on the true value of the company, rather than on stale or incomplete information. Efficient prices help reduce costs for investors,

since there is less need to spend money on research and analysis of public information when prices already reflect all relevant information. The cost savings are particularly beneficial to retail investors, who typically possess less expertise and fewer resources than institutional investors. *See*, *e.g.*, Jennie Bai *et al*., *Have Financial Markets Become More Informative?*, 122 J. Fin. Econ. 625 (2016). The promotion of efficient prices also helps minimize large price swings in a stock and reduces the likelihood and magnitude of bubbles. *See*, *e.g.*, Ernan Haruvy & Charles N. Noussair, *The Effect of Short Selling on Bubbles and Crashes in Experimental Spot Asset Markets*, 61 J. Fin. 1119 (2006).

Not only do stock market investors benefit from price efficiency, but public firms themselves also benefit from lower costs of capital. When stock prices are more reflective of a firm's fundamental value and less prone to volatile price swings, investors are more willing to provide capital, *see, e.g.,* Jonathan Brogaard *et al*., *Noisy Stock Prices and Capital Allocation Efficiency* (Jan. 2022) (unpublished manuscript), *available at* tinyurl.com/2btf7cen, thus lowering the cost of capital. In this way, price efficiency improves capital allocation efficiency, as the most deserving firms become more likely to receive the low-cost capital necessary for growth.

(iii) Short selling increases liquidity in the market.

Short selling also positively affects overall market quality by increasing liquidity in the stock market. Since short selling represents approximately half of all stock market trading volume, short sellers clearly play a prominent role in supplying liquidity to U.S. equity markets. *See* 88 Fed. Reg. at 75,151. However, the liquidity benefits of short selling extend beyond merely adding to trading volume. Empirical research establishes that the liquidity supplied by short sellers lowers transaction costs significantly for all stock market participants. *See* Alessandro Beber & Marco Pagano, *Short-Selling Bans Around the World: Evidence from the 2007-09 Crisis*, 68 J. Fin. 343 (2013).

Lower transaction costs allow for higher portfolio returns for all investors, including pension funds and mutual funds that manage significant amounts of U.S. retirement savings. Increased liquidity also allows for more efficient allocation of investment dollars as capital can flow more freely based on company fundamentals and without transaction cost frictions.

II. Mandatory short sale disclosures constitute a *de facto* short selling restriction that significantly harms markets.

Given the well-established benefits of short selling, it follows that the imposition of bans or restrictions on short selling is harmful to capital markets. Outright bans on short selling have a clearly detrimental effect, as short sellers are

no longer incentivized to monitor firm management. Abolition of short selling would erase both the price efficiency improvements (as short sellers would no longer help incorporate fundamental information into a firm's stock price), as well as the liquidity benefits (as the significant trading volumes and reductions in transaction costs disappear). Regulatory restrictions on short selling that do not entail a complete ban but rather curb short selling activity inflict similar damage. Mandatory public disclosure of short selling activity, such as that promulgated under the Securities Lending Rule, constitutes a *de facto* regulatory restriction since such disclosure has been shown to substantially chill short selling activity.

Disclosure mandates reduce short selling activity due to the significant costs that such disclosure entails. Critically, execution of a short selling strategy typically does not occur with a single trade at a single point in time, but rather involves a cumulative buildup of a short position over many days. *See* 88 Fed. Reg. at 75,163 and n.629. In many cases, the average daily trading volume in a shorted stock may be relatively low as compared to the size of the desired short position. Therefore, it is more cost efficient to establish a short selling position over time. As a result, it is essential for the execution of a short sale strategy that details of the strategy remain confidential. Otherwise, revealing proprietary short sale trading strategies can expose a short seller to (i) losses due to copycat trading, (ii) losses due to short squeeze attacks, and (iii) retaliation concerns. Each of these can significantly

diminish the potential returns to the short seller. While the SEC acknowledges and addresses these risks in the Short Selling Rule, *see*, *e.g.*, *id.* at 75,132, it ignores them in the Securities Lending Rule.

A "copycat trade" occurs where an investor imitates the short selling strategy of the original short seller, *i.e.*, short selling the same stock. When this occurs, copycat short selling may drive down the price of the stock before the original short seller has completed its full short sale trade. Since short sellers profit by selling high and subsequently buying low, the accelerated decrease in stock price caused by the copycat trader represents lost profits to the original short seller, who can no longer continue to sell short at the higher price.

"Short squeezes" pose the opposite problem for short sellers. A short squeeze occurs when there is a sharp increase in the price of the stock, prompted by a sudden surge in buying activity, which imposes significant losses on the short seller's position. As losses to the short seller increase, the short seller may want or need to exit its short position to limit further losses in the face of a rising stock price.

Short squeezes are often the result of targeted campaigns by traders seeking to profit from forcing short sellers to buy the stock, thus closing their positions (*i.e.*, "squeezing out" the short sellers). Traders who conduct a short squeeze can earn significant returns as the forced buying by short sellers further increases the price of

the stock. The larger the short position, the more opportunity for returns on a short squeeze attack.

The risks of copycat trading and short squeezes are materially higher if short positions are disclosed to the public relatively quickly. Rapid disclosure of short-sale activity, as would occur under the Securities Lending Rule, provides the market with the necessary short selling signals that can prompt such costly responses. Whether copycat trades or short squeezes, the losses imposed on the short seller can be so detrimental to returns that the short seller forgoes engaging in the short sale strategy in the first place.

Disclosure of short positions can also expose the short seller to other forms of retaliation, including nuisance lawsuits and intimidation. *See* Letter from Jennifer W. Han, Chief Counsel, Managed Funds Assoc., to Vanessa Countryman, Sec'y, Sec. & Exch. Comm'n, at 9 (Apr. 26, 2022) *available at* tinyurl.com/jk2rwfpm. Short sellers have also expressed concerns that public disclosure can trigger retaliation from the shorted firms themselves through exclusion from corporate management access events, effectively inhibiting the ability of short sellers to analyze a firm's fundamentals. *See* Letter from Jiří Król, Dir. of Gov't & Reg. Affairs, Alt. Inv. Mgmt. Assoc., and Stuart J. Kaswell, Managing Director, Managed Funds Assoc., to Eur. Sec. & Mkts. Auth. (Mar. 15, 2013) *available at* tinyurl.com/2wfatvp8.

Facing the threat of the foregoing costs, short sellers will be disincentivized to conduct short sale strategies given the significant upfront research costs typically required to identify a potentially profitable short sale. Overall, short-sale activity will drop as a result. Corporate governance will suffer as short sellers become less likely to monitor for corporate wrongdoing. Market efficiency will suffer as short sellers become less incentivized to identify mispriced stocks, thus greatly reducing the associated price efficiency and liquidity benefits.

Empirical research confirms that daily disclosure requirements significantly reduce short sale activity, clearly illustrating that such regulatory mandates serve as a form of short selling restriction. Stephan Jank *et al.*, *Flying Under the Radar: The Effects of Short-Sale Disclosure Rules on Investor Behavior and Stock Prices*, 139 J. Fin. Econ. 209 (2021). Importantly, the short sellers who typically curb short selling activity the most in the face of disclosure requirements are generally the more successful short sellers as measured by returns. *Id.* Under the fair assumption that the more successful short sellers are also the best informed – as is presumed in the academic literature – those short sellers with the best information are also those most likely to reduce their short-selling activity. *Id.* Since corporate governance and price efficiency are naturally most improved by traders with superior information, the specific loss of well-informed short selling activity is particularly damaging to the overall market.

The detrimental effects of short selling disclosures, specifically on corporate governance and price efficiency, have been well established. Empirical reviews of global regulatory approaches to short selling conclude that short selling disclosure requirements increase the likelihood of corporate misconduct, such as earnings manipulation. *Id.* Moreover, the decline in short sale activity resulting from disclosure mandates has been specifically found to hamper price efficiency in the affected market. *Id.*

III. The Securities Lending Rule will expose short selling positions and significantly curb short selling activity.

Short selling and securities lending are substantially intertwined financial market activities, in many cases entailing a one-to-one mapping between the two. Given the significant interrelationship between short selling and securities lending, the SEC's disclosure requirements in the Securities Lending Rule are in many cases tantamount to direct disclosure of the related short selling activity.

(i) Securities lending and short sales are two sides of the same coin.

In a typical sale of stock, the seller must deliver shares to the buyer to settle the transaction. In a short sale, the seller does not actually own the stock, so the seller often borrows the shares from a third party to deliver to the buyer. This borrowing of stock, conducted as part of the short sale transaction, is securities lending activity.

Therefore, the link between short selling and securities lending is both intrinsic and direct.

Because of the close relationship between short selling and securities lending, information related to a securities lending transaction inherently provides information about the related short selling activity. Indeed, securities loans are commonly considered as proxies for short sale activity, since the securities loan signals that an associated short sale has been conducted. *See*, *e.g.*, 88 Fed. Reg. 75,155 and n.560. For example, public disclosure of a $1 million *loan* of Microsoft stock may also constitute public disclosure of a $1 million *short sale* of Microsoft stock, purely through disclosure of the securities lending transaction.

To be clear, not all securities lending is necessarily associated with a short sale, as there are some motivations for borrowing a stock without an intention to conduct a short sale (*e.g.*, a broker may borrow a stock to make delivery to a clearinghouse to cover a customer's failure to deliver that stock). However, the details required to be disclosed under the Securities Lending Rule allow for clear identification of which securities loans have an associated short sale, as described below.

(ii) The Securities Lending Rule entails significant disclosures of short positions.

Table 1 sets forth the disclosure requirements imposed by the Short Selling Rule and Securities Lending Rule.

Table 1

	Short Selling Rule	**Securities Lending Rule**
Daily Disclosure	None	Disclosed the day after transaction: (1) *Individual* transaction data for (i) borrower type, (ii) fee rate, (iii) number of loans (2) Unique ID assigned to each *individual* transaction. (3) Aggregated securities lending activity for each stock. 88 Fed. Reg. at 75,741-42.
Delayed Disclosure	Disclosed within one month *of the end* of the reporting month: (1) *Aggregated* gross short positions for a stock (2) *Aggregated* daily net short activity for the previous month	Disclosed 20 business days after transaction: (1) Daily *individual* transaction loan amounts 88 Fed. Reg. at 75,742.

	88 Fed. Reg. at 75,102, 75,104, 75,185.	

As shown in Table 1, the Securities Lending Rule requires significant individual transaction-level details of securities loans to be made public the day after the lending transaction occurs, in stark contrast to the Short Selling Rule's one-month delay. *Compare* 88 Fed. Reg. at 75,741 *with* 88 Fed. Reg. at 75,102. In particular, the SEC mandates public disclosure of the type of borrower (*e.g.*, whether the borrower is a customer, broker or dealer, bank, *etc*.) as well as the fee rate associated with the loan. 88 Fed. Reg. at 75,741. Securities loans to "customers" are closely linked to short selling transactions, thus enabling the identification of whether a securities loan represents a short sale transaction or otherwise, a fact that the SEC concedes in the Securities Lending Rule's final release. *See, e.g., id.* at 75,696.

The disclosed fee rate for each securities loan to a customer also reveals important details about the associated short sale position. The fee associated with a securities loan is often based largely on the specific relationship between the lender and borrower.[3] Short sellers who maintain active relationships with securities

[3] Indeed, the SEC acknowledges that "there is usually a significant range of borrowing costs for loans of the same security on the same day to different entities." 88 Fed. Reg. at 75,695.

lenders may negotiate relatively more attractive (*i.e.*, lower) fees. As such, public disclosure of a securities loan with lower fees can signal to the rest of the market that an active short seller is engaged in a short selling strategy. Since the specific stock name being lent is also disclosed, *id.* at 75,741, potential copycats or short squeezers have all the information that they need to trigger an attack on the short seller.

(iii) The Securities Lending Rule enables daily tracking of short sale strategies.

Not only does the Securities Lending Rule provide sufficient information for public identification of short sale positions on a daily basis, the rule also facilitates continual tracking of a short sale strategy. Each securities loan disclosed under the Securities Lending Rule is assigned a unique identification number published along with the details of the loan. *Id.* Since subsequent loan modifications are also published daily, *id.* at 75,742, and will be identified by the unique ID, short positions will not only be revealed when first established but can also be tracked over time. This will allow continual monitoring of specific short sale strategies, thus further enabling potential attacks through copycat trades and short squeezes, arguably with enhanced ability to time an attack given the daily tracking capabilities.

Overall, the rapid daily disclosure of short positions will significantly hamper the ability of short sellers to execute an effective short sale strategy. Short sellers

will undoubtedly curb their short-selling activity as a result, thus triggering the loss of significant benefits to U.S. capital markets.

IV. The SEC's approach to short-selling disclosure is self-contradictory and unprecedented.

The disclosure mandates imposed by the Securities Lending Rule and the Short Selling Rule are contradictory, despite their having been promulgated within minutes of each other by the SEC. This contradictory approach to regulating the same financial market activity renders the promulgation of the two rules arbitrary and capricious under the APA.

In the final rule release for the Short Selling Rule, the SEC acknowledges the need to address the significant costs to short sellers and resulting harm to financial markets of revealing too much information. *See* 88 Fed. Reg. at 75,132 (noting that the rule "must balance competing interests of public transparency against the potential negative impacts on price discovery, and of short position and short activity disclosures as well as data security concerns"). The SEC even acknowledges that "[t]he easier it is for a market participant to deduce the identities of individual short sellers, the greater the risk of retaliation, copycat trading and other market activity that might have an undesired chilling effect on price discovery." *Id.* The SEC further concedes the importance of delaying publication of short selling information. *Id.* at 133 (noting that "the Commission anticipates that many potential negative effects

on the market will be mitigated by the delay in publication of the aggregated data"). Overall, the SEC concludes in the context of the Short Selling Rule that the best approach to disclosing short sale information is to publish aggregated data on a delayed basis. *Id.* (noting that, "the Commission is adopting as proposed the approach of publishing, on a delayed basis, aggregated short sale-related data….").

Accordingly, the Short Selling Rule mandates disclosure of *nothing* until approximately one month after the short sale transaction occurs, and potentially longer, depending on when the short sale occurs during the reporting month.[4] Moreover, transaction-level data are *never* publicly disclosed. Instead, only aggregated data are disclosed, capturing gross and net short selling positions. *Id.* at 75,104.

Despite its reasoned approach to disclosure in the Short Selling Rule, the SEC performs a *volte-face* in the Securities Lending Rule. By requiring the publication of significant transaction-level securities lending data without delay under the Securities Lending Rule, the SEC is revealing the very same sensitive short selling information that the SEC had already concluded was important enough to protect through aggregation and delay in the Short Selling Rule. The Securities Lending Rule's daily disclosure requirement is particularly egregious given that the SEC

[4] All data will be published within one calendar month after the end of the reporting month (*e.g.*, shorting data related to October will be published by the end of November).

conceded that even the one-month delay in the Short Selling Rule may not eliminate the harm to short sellers. *See id.* at 75,163-64.

The SEC argues that the 20-business day delay of transaction loan *amounts* by the Securities Lending Rule will mitigate concerns associated with disclosure. 88 Fed. Reg. at 75,709-11. However, the delay of that single component of the transaction does *not* mitigate the damage imposed by the rest of the mandated disclosures. The daily transaction-level details mandated under the Securities Lending Rule provide sufficient information to allow for public identification of short positions without the individual loan amounts. Moreover, the SEC's attempt to mitigate concerns by imposing a 20-business day delay was a material departure from the proposed Securities Lending Rule, *id.* at 75,649, on which the SEC never solicited comments. Thus, the public was unable to provide input on the lack of effectiveness of delaying disclosure of loan size alone.

Short selling is a concentrated market with relatively few investors engaging in large volume short selling strategies. *See* 88 Fed. Reg. at 75,150 (as of December 2022, only 15 out of 7,164 registered investment companies held short positions of $10 million or more, while only 16% of single-strategy hedge funds engaged in short selling); *see also id.* at 75,160 (the SEC estimates that 39% of stocks reported on Form SHO would have only one short seller holding a large short position). Given the relatively few players involved, any noticeable daily movement in (i) *aggregate*

loan activity, (ii) fees rates, and (iii) number of loans, coupled with the identification of the type of borrower, will tip off to the rest of the market that a short-selling strategy has been initiated. The specific identity of the short seller can likely be surmised as well, particularly for stocks that typically involve only a single active short seller. All this can be accomplished on a daily basis even absent disclosure of loan size, rendering the 20-day delay of that single data point inconsequential.

While the SEC acknowledges the concentration of short sellers in the context of the Short Selling Rule, it makes no reference to this important point in the Securities Lending Rule. The CBA in the Securities Lending Rule entirely fails to consider how daily disclosure of loan details will cause damaging public revelations in such a concentrated market. The CBA also fails to consider whether other market participants can reverse engineer a short-selling strategy with the several other daily signals provided under the rule. The SEC's failure to conduct an adequate economic analysis of the Securities Lending Rule, including its explicit contradiction of the policies underlying the simultaneously finalized Short Selling Rule, constitutes a violation of the SEC's statutory obligation under the Exchange Act to "consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation." 15 U.S.C. § 77b(b). Consequently, the Court should invalidate both the Securities Lending Rule and the Short Selling Rule as

"arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law" pursuant to the APA. 5 U.S.C. § 706.

In addition to the direct contradiction between the two rules at issue, the SEC's mandated disclosure of daily transaction-level short selling information is also unprecedented and discordant with existing disclosure regimes on the "long" side of the market. Institutional asset managers, including hedge funds, have long been required to disclose long stock positions through Form 13F filings. 17 C.F.R. § 240.13f-1. However, such disclosures are only mandated on a quarterly basis, *id.* § 240.13f-1(a)(1), largely based on the same fears of copycat trading as plagues the rules at issue here. The quarterly disclosure frequency highlights the importance of the confidentiality of trading positions and the unprecedented nature of the Securities Lending Rule's daily disclosure requirement. It is confounding – and unexplained by the SEC – why a hedge fund engaged in a long stock trade can protect the confidentiality of the trade for three months, as is reasonable, but is barely afforded a single day on the short side.

V. The SEC was not compelled by statute to mandate daily, transaction-level disclosure.

While the Short Selling Rule and the Securities Lending Rule each stem from a statutory mandate in the DFA, 15 U.S.C. § 78m(f)(2), nothing in the DFA prevents the SEC from implementing a consistent approach towards short-selling disclosure

requirements across both rules. As noted by the SEC, the DFA mandate for the Short Selling Rule requires public disclosure of the "*aggregate* amount of the number of short sales of each security" and that public disclosure occur at least every month. 88 Fed. Reg. at 75,101 (emphasis added) (quoting Section 929X of the DFA). At the same time, the Securities Lending Rule is promulgated under a DFA mandate that the SEC "increase the transparency of information available to brokers, dealers, and investors with respect to loan or borrowing securities." 88 Fed. Reg. at 74,646 n.24 (quoting Section 984(b) of the DFA). Nothing in the statutory mandate for the Securities Lending Rule necessitates daily disclosure of transaction-level data, and nothing suggests that the SEC could not have taken the same delayed aggregated approach toward securities lending disclosure. The SEC should not be permitted to circumvent clear congressional intent for *aggregate* short sale disclosure by mandating daily disclosure of the same activity through different means.

CONCLUSION

The mandated daily disclosures in the Securities Lending Rule impose unjustified and unprecedented harm to a vital function of U.S. capital markets. Short selling has been firmly established as playing an essential role in financial markets, conferring extensive corporate governance and market quality benefits. As such, any regulation that will disrupt the functioning of short-selling activity must balance these costs against the purported benefits of the rule. The SEC acknowledged the

importance of such a balance in the Short Selling Rule but completely disregarded and contradicted that approach in the Securities Lending Rule. The result is that a critical financial market function will be significantly curtailed, and several of its benefits will be lost to U.S. companies and investors. The contradictions of the Short Selling Rule and the Securities Lending Rule are fatal to any attempt by the SEC to justify its rulemakings as the product of reasoned decision making, as the APA requires. Moreover, the SEC has violated its statutory obligation under the Exchange Act, 15 U.S. Code § 77b(b), to conduct a rigorous economic analysis by failing to consider the negative effect that the Securities Lending Rule will have on U.S. capital markets.

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CERTIFICATE OF SERVICE

I hereby certify that, on March 12, 2024, I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Fifth Circuit by using the CM/ECF system. I certify that all participants in this case are registered CM/ECF users and that service will be accomplished by the CM/ECF system.

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CERTIFICATE OF COMPLIANCE

I certify that:

1. This brief complies with the type-volume limitation of Fed. R. App. P. 29(a)(5) because it contains 5,791 words, excluding the parts of this brief exempted by Fed. R. App. P. 32(f) and Circuit Rule 32.2.

2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and Circuit Rule 32.1 and the type-style requirements of Fed. R. App. P. 32(a)(6) because it has been prepared in a proportionally spaced typeface using Microsoft Word in 14-point font.

3. Any required privacy redactions have been made pursuant to Circuit Rule 25.2.13, the electronic submission is an exact copy of the paper submission, and the brief has been scanned for viruses and is free of viruses.

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