Chapter 13

SROs, Marketplaces and Clearing Agencies

13.1 SROs

13.1.1 IIROC Rules Notice – Request for Comments – Provisions Respecting Regulation of Short Sales and Failed Trades

IIROC NOTICE

RULES NOTICE

REQUEST FOR COMMENTS

PROVISIONS RESPECTING REGULATION OF SHORT SALES AND FAILED TRADES

11-0075
February 25, 2011

Provisions Respecting Regulation of Short Sales and Failed Trades

Summary

This IIROC Notice provides notice that, on January 27, 2011, the Board of Directors ("Board") of the Investment Industry Regulatory Organization of Canada ("IIROC") approved the publication for comment of proposed amendments ("Proposed Amendments") to the Universal Market Integrity Rules ("UMIR") respecting the regulation of short sales and failed trades. In particular, the Proposed Amendments would:

- ***repeal the restrictions on the price at which a short sale may be made*;**
- require, subject to certain exceptions, that a Participant or Access Person to have made arrangements to borrow securities that would be necessary to settle any short sale prior to the entry of the order on a marketplace if:
    - the security has been designated by IIROC to be a "Pre-Borrow Security",
    - the client or non-client account on whose behalf the short sale order is being entered has previously executed an "Extended Failed Trade" (a "failed trade" that was not rectified within ten trading days following the date for settlement contemplated on the execution of that trade), or
    - the Participant had executed, as principal, an "Extended Failed Trade" in that particular security,
- require a sell order from a short position to continue to be marked "short sale" but introduce an exemption from the short sale marking requirements for orders from certain types of accounts;
- change the use of the "short exempt" order designation to provide that it be used in connection with orders for the ***purchase or sale*** of a security by an arbitrage account, an account of a person with market making, odd lot and other marketplace trading obligations ("Marketplace Trading Obligations")[1] or certain institutional accounts that adopt a "directionally neutral" strategy in the trading of securities; and
- make a number of administrative and editorial changes.

In addition, the Board authorized the withdrawal from further consideration an earlier proposal to repeal the requirements related to the preparation and filing of semi-monthly short position reports.

[1] IIROC has proposed to amend UMIR to define the term "Marketplace Trading Obligations" which would include various market making, odd lot and other marketplace trading obligations. See IIROC Notice 10-0113 – Rules Notice – Request for Comments – UMIR – *Provisions Respecting Market Maker, Odd Lot and Other Marketplace Trading Obligations* (April 23, 2010).

Rule-Making Process

IIROC has been recognized as a self-regulatory organization by each of the Canadian provincial securities regulatory authorities (the "Recognizing Regulators") and, as such, is authorized to be a regulation services provider for the purposes of National Instrument 21-101 ("Marketplace Operation Instrument") and National Instrument 23-101.

As a regulation services provider, IIROC administers and enforces trading rules for the marketplaces that retain the services of IIROC.[2] IIROC has adopted, and the Recognizing Regulators have approved, UMIR as the integrity trading rules that will apply in any marketplace that retains IIROC as its regulation services provider.

The Market Rules Advisory Committee of IIROC ("MRAC") reviewed the Proposed Amendments prior to their consideration by the Board. MRAC is an advisory committee comprised of representatives of each of: the marketplaces for which IIROC acts as a regulation services provider; Participants; institutional investors and subscribers; and the legal and compliance community.

The text of the Proposed Amendments is set out in Appendix "A". The Proposed Amendments are part of an overall strategy to monitor and regulate short sales and failed trades in the Canadian equity marketplaces which the Board has determined to be in the public interest. Comments are requested on all aspects of the Proposed Amendments, including any policy alternatives to the Proposed Amendments that commentators consider preferable and/or more effective to achieve the intended objectives. Comments should be in writing and delivered by ***May 26, 2011*** to:

James E. Twiss,
Vice President, Market Regulation Policy,
Investment Industry Regulatory Organization of Canada,
Suite 900,
145 King Street West,
Toronto, Ontario. M5H 1J8

Fax: 416.646.7265
e-mail: jtwiss@iiroc.ca

A copy should also be provided to Recognizing Regulators by forwarding a copy to:

Susan Greenglass
Director, Market Regulation
Ontario Securities Commission
Suite 1903, Box 55,
20 Queen Street West
Toronto, Ontario. M5H 3S8

Fax: (416) 595-8940
e-mail: marketregulation@osc.gov.on.ca

Commentators should be aware that a copy of their comment letter will be made publicly available on the IIROC website (www.iiroc.ca under the heading "Policy" and sub-heading "Market Proposals/Comments") upon receipt. A summary of the comments contained in each submission will also be included in a future IIROC Notice.

After considering the comments on the Proposed Amendments received in response to this Request for Comments together with any comments of the Recognizing Regulators, staff of IIROC may recommend that revisions be made to the Proposed Amendments. If the revisions are not of a material nature, the Board has authorized the President to approve the revisions on behalf of IIROC and the Proposed Amendments as revised will be subject to approval by the Recognizing Regulators. If the revisions are material, the Proposed Amendments as revised will be submitted to the Board for ratification and, if ratified, will be republished for further public comment.

[2] Presently, IIROC has been retained to be the regulation services provider for: the Toronto Stock Exchange ("TSX"), TSX Venture Exchange ("TSXV") and Canadian National Stock Exchange ("CNSX"), each as an "exchange" for the purposes of the Marketplace Operation Instrument ("Exchange"); and for Alpha Trading Systems ("Alpha"), Bloomberg Tradebook Canada Company, Chi-X Canada ATS Limited ("Chi-X"), Liquidnet Canada Inc. ("Liquidnet"), Omega ATS Limited ("Omega") and TriAct Canada Marketplace LP (the operator of "MATCH Now"), each as an alternative trading system ("ATS"). CNSX presently operates an "alternative market" known as "Pure Trading" that is entitled to trade securities that are listed on other Exchanges and that presently trades securities listed on the TSX and TSXV.

Development of Proposals for the Canadian Market

IIROC has undertaken a process of evaluating additional steps which might be taken in Canada to deal with issues related to short sales and failed trades. These possible steps include additional amendments to UMIR, changes in the procedures and monitoring systems of IIROC and co-operation in data collection and sharing with the Ontario Securities Commission ("OSC") and the CDS Clearing and Depository Services Inc. ("CDS").

Objectives of the Proposed Response

In developing the proposals for the further regulation of short sales, IIROC sought to ensure that any rules, guidance and monitoring regime:

- is supported by the empirical evidence regarding short sales and failed trades in the Canadian market;
- is part of a comprehensive monitoring of market integrity risks (e.g. restricting short sales may not be the appropriate response to all "rapid" price declines);
- is neutral, in that it treats "unusual" price movements of a security, whether up or down, as a reason for increased regulatory scrutiny;
- is focused, in that the burden for compliance is placed on those that have failed to comply with the requirements;
- is practical, in that marketplaces and dealers can comply with the requirements in a cost effective manner;
- is proportionate, in that the proposals do not invoke a regulatory response which results in a deterioration of market quality for all market participants; and
- is effective, in that the proposals do not impede the proper uses of short selling and the liquidity that such proper activity provides to the market.

Elements of the Proposed Response

Repeal of Price Restrictions on Short Sales

In the United States, the Securities and Exchange Commission ("SEC") adopted Rule 201 which will be implemented on February 28, 2011 and provides that there is no price restriction or "tick test" for short sales unless a circuit breaker has first been triggered by a 10% price decline in a particular security, in which case a short sale must be entered at a price that is one increment above the best bid price for the balance of that trading day and the next trading day.[3] In commentary before the SEC during the hearing that approved Rule 201, it was estimated that the circuit breaker would apply to only 1.7% of securities for a maximum period which is less than two trading days. Given the required price decline, coupled with the relatively short period of time during which price restrictions on short sales apply after imposition, the majority of US market activity is not subject to a tick test.

Studies by IIROC support the premise that the tick test has no appreciable impact on pricing and, in light of that, IIROC believes that there are better mechanisms to detect and address abusive short selling. Under the Proposed Amendments, IIROC would proceed with the outstanding proposal to repeal the tick test but will also continue to work with other Canadian regulators to enhance measures intended to identify and address incidents of "abusive" short selling.

Enhancement of Investor Confidence

While the SEC adopted Rule 201 ostensibly to enhance "investor confidence" in short selling activity, its adoption may have also served to reinforce the preconception that rapid price declines are generally the result of abusive short selling.[4] It is interesting to note that in response to the "Flash Crash" which saw significant price declines on US markets in a broad range of securities over a very short period of time on May 6, 2010, the SEC introduced "single-stock circuit breakers" which provided for a trading halt if the price of a security dropped more than 10% in a five minute period. While single-stock circuit breakers have been in effect in the United States since June 11, 2010, short selling activity has not been identified by the market centers as a factor in any of the incidents in which a single-stock circuit breaker was triggered.

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[3] See SEC Release 34-6159 – *Regulation SHO* (February 26, 2010) and SEC Release 34-63247 – *Regulation SHO* (November 4, 2010).

[4] In testimony before Congress concerning the severe market disruption on May 6, 2010, the Chair of the SEC did not list "short selling" as one of the causes of the precipitous decline in equity prices between 2:00 and 3:00 p.m. on May 6, 2010. There are reports that short selling actually declined during this period – a finding which would be consistent with the studies undertaken by IIROC.

The adoption of Rule 201 may have the unintended effect of encouraging retail investors to sell at the first opportunity following the triggering of a circuit breaker in order to avoid further downward price pressure, which in turn would inadvertently put more downward price pressure on the security. In the view of IIROC, investor confidence is best bolstered by:

- educating investors and, to a lesser extent, the industry as to the role of short selling in ordinary trading activity (including releasing existing empirical studies undertaken by IIROC and supporting future academic research, particularly on the impact of the repeal of the tick test);
- enhancing the transparency of short selling activities and the occurrence of failed trades in the trading of each security;
- transparency as to the monitoring by IIROC and the circumstances when IIROC would pursue "regulatory intervention"; and
- adherence to the general principles of short sale regulation enunciated by the International Organization of Securities Commissions ("IOSCO") taking into consideration the unique characteristics and practices of the Canadian market.

Transparency

In an effort to enhance the transparency of short selling activity in the Canadian market, the following steps will be taken:

- concurrent with the implementation of the Proposed Amendments, IIROC would expect to be in a position to produce, and to disseminate publicly, a semi-monthly report on the proportion of "short sales" in the total trading activity of each security across all marketplaces which should help establish a better appreciation for the "normal" levels of short selling for each security;
- IIROC, in cooperation with the OSC and CDS, is working to introduce a system that would produce information relating to trade failures for each listed security; and
- IIROC is withdrawing a proposal to repeal the requirements for the preparation of short position reports and, as a result, the Consolidated Short Position Report ("CSPR") will continue to be produced on a semi-monthly basis.

While Rule 10.10 of UMIR requires Participants and Access Persons to file short position reports, the CSPR is produced for securities listed on the TSX and TSXV by the TSX which makes certain of the information publicly available[5] and provides the full CSPR on a subscription basis. A separate CSPR is produced by CNSX for securities listed on that exchange.

In addition to the Proposed Amendments and other IIROC initiatives described in this IIROC Notice, the Canadian Securities Administrators ("CSA") and IIROC are proposing to publish a joint notice to solicit feedback on whether additional proposals to enhance disclosure of short sales and failed trades are required ("Joint Notice").

Limitation of Regulatory Arbitrage Opportunities

In a limited number of cases, securities which are inter-listed between an Exchange in Canada and an exchange in the United States may become subject to the U.S.'s Rule 201 short sale restriction if the "circuit breaker" has been triggered. When Rule 201 is implemented in the United States, regulatory arbitrage can be avoided even if Canada does not adopt the same circuit breaker system and alternative uptick rules. In part, this requires Canada being able to demonstrate that its regime effectively addresses "abusive" short selling through other mechanisms, including real-time alerts based on trading activity across all Canadian marketplaces.

IIROC is currently in the process of developing an alert for its surveillance system that will monitor for unusual levels of short selling activity, coupled with significant price movements. If unusual levels of short selling are detected which are disruptive to the market, IIROC also has the ability to intervene to vary or cancel the prices of any trade that is "unreasonable" or, in particularly egregious circumstances, to impose a halt on trading of a particular security across all marketplaces. In addition, IIROC has the ability to designate a security as a "Short Sale Ineligible Security" for a period of time.

[5] The TSX provides information on the 20 largest short positions and the 20 largest increases and decreases in positions from the previous report for securities listed on the TSX and for securities listed on the TSXV.

"Regulatory Intervention"

Currently, IIROC's policies and procedures for undertaking a regulatory intervention to halt trading in a security or to vary or cancel trades are not publicly disclosed. In a separate initiative, IIROC has published for public comment draft guidance that would provide greater transparency of IIROC's existing policies and procedures relating to the variation or cancellation of "unreasonable" trades and trades which are not in compliance with the requirements of UMIR.[6] In addition, IIROC has published for public comment draft guidance respecting the implementation of "Single-Stock Circuit Breakers" that would halt trading in a particular security for a short period of time if that security experienced rapid, significant and unexplained price movement.[7] IIROC believes that these approaches to monitoring significant, unexplained price movements may be preferable in the Canadian context to the U.S. restrictions on short selling following the triggering of a "circuit breaker" under Rule 201 for the reasons outlined later in this notice under the heading "Short Sale Circuit Breakers".

Enhanced Monitoring

As part of any response, IIROC should enhance its monitoring of short sales and failed trades. In particular:

- IIROC is introducing a web-based system which will facilitate Participants' reporting of "Extended Failed Trades", defined as trades which the client has failed to resolve within 10 business days following the regular settlement date. This reporting system will identify "problem" fails and allow IIROC to assess the reasons for the failure and monitor the steps being taken to resolve the problem.

- IIROC will employ a new trading alert which will look for declines in the price of a security associated with changes in the rate of short selling, based on a comparison to historical short selling patterns for the particular security. This will also allow IIROC to determine if short selling is becoming concentrated within particular dealers or clients.

- CDS is providing data to the OSC on daily trade failures for trades settling in the continuous net settlement facilities ("CNS") of CDS. Access to this database would allow IIROC to determine, from time to time, variations in trade failures from historic patterns for particular securities and Participants.

- As part of the Proposed Amendments, IIROC is proposing that purchase and sale orders from arbitrage accounts, accounts of persons with Marketplace Trading Obligations and certain institutional accounts that adopt a "directionally neutral" strategy in the trading of securities would carry a "short-marking exempt order" designation. The use of this order designation would permit the data on "short sales" to better reflect the activities of persons who may have adopted a "directional" trading strategy.

Pre-Borrow Requirements

Rule 2.2 of UMIR deals with those activities which are considered to be "manipulative and deceptive" and, as such, prohibited. The entering of an order for the sale of a security without, at the time of entering the order, having the reasonable expectation of settling any trade that would result from the execution of the order constitutes a violation of the prohibition on manipulative and deceptive activities. As such, "naked short selling", as that term is sometimes understood, is not permitted under UMIR.[8] The provisions of Rule 2.2 of UMIR do not require the Participant or Access Person that is entering a short sale to have made a "positive affirmation" prior to the entry of the order that it can borrow or otherwise obtain the securities that would be required to settle a short sale. However, once a Participant or Access Person is aware of difficulties in obtaining particular securities to make settlement of any short sale the Participant or Access Person would no longer have a "reasonable expectation" of being able to settle a resulting trade and therefore would not be able to enter further short sale orders. For trading in a particular security, certain Participants or Access Persons who do not have the ability to borrow that security may be precluded from entering short sales while other Participants or Access Persons with the ability to borrow that security may continue to undertake additional short sales.

Even when the person entering an order has "reasonable expectations" of being able to settle any resulting trade, there may be circumstances in which the person should be required to have made arrangements to "pre-borrow" the securities which are the subject of a short sale. These types of circumstances may include when:

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6 See IIROC Notice 10-0331 - Rules Notice – Request for Comments – UMIR – *Proposed Guidance on Regulatory Intervention for Variation or Cancellation of Trades* (December 15, 2010).

7 See IIROC Notice 10-0298 - Rules Notice – Request for Comments – UMIR – *Proposed Guidance Respecting the Implementation of Single-Stock Circuit Breakers* (November 18, 2010).

8 There is no universally accepted definition of "naked short selling". The most common usage is in connection with a short sale when the seller has not made arrangements to borrow any securities that may be required to settle the resulting trade. Some commentators use a more restrictive interpretation that describes any short sale when the seller has not pre-borrowed the securities necessary for settlement.

- the person making the short sale has previously executed trades which have failed to settle on the date scheduled for settlement and within a reasonable time after that date; and

- rates of settlement failure for a particular security have increased above historic levels and the increase is attributable to short selling activity.

Summary of the Proposed Amendments

Price Restrictions on Short Sales

Current Requirements

Rule 3.1 of UMIR provides that, subject to certain exemptions, neither a Participant nor an Access Person may make a short sale below the "last sale price". IIROC set out an administrative interpretation that would also allow a Participant or Access Person, as applicable, when determining the "last sale price" of a particular security to rely on trade information from:

- a consolidated market display that includes trade information received in a timely manner from all marketplaces;

- regular trading on the "principal market" for the trading of that security;

- regular trading on the Exchange on which the security is listed; or

- the marketplace on which the order will be entered provided such trade on that marketplace has been executed subsequent to the last sale on the principal market or the Exchange on which the security is listed.[9]

Proposed Repeal of Price Restrictions

The Proposed Amendments would repeal all restrictions on the price at which a short sale may be made. The Proposed Amendments would parallel action taken by the SEC to repeal price restrictions on short sales in the United States effective July 7, 2007.

While the restrictions on the price at which a short sale may be executed would be repealed under the Proposed Amendments, the requirement to mark an order as "short" would continue.

Pre-Borrow Requirements

Under the Proposed Amendments, a Participant or Access Person would be given specific direction as to the need, subject to certain exceptions, to have made arrangements to borrow securities when entering an order that on execution would be a short sale of:

- any listed security on behalf of a client or non-client[10] that previously had an Extended Failed Trade in any listed security; or

- a particular security by the Participant or Access Person acting as principal if the Participant or Access Person had previously had an Extended Failed Trade in respect of a principal trade in that particular security.

An Extended Failed Trade is one in respect of which notice of the failed trade was required to be provided to IIROC in accordance with Rule 7.10 of UMIR as the reason for the failure had not been rectified within ten trading days following the date for settlement contemplated on the execution of the failed trade.

If an Extended Failed Trade report has been filed previously at any time by a Participant with IIROC with respect to an Extended Failed Trade in the account of a client or non-client, that client or non-client would not be able to enter an order that on execution would be a short sale without having made arrangements to borrow the securities necessary to settle any resulting trade until:

- the Participant through which the order is to be entered on a marketplace is satisfied, after reasonable inquiry, that the reason for any prior failed trade was solely as a result of administrative error and not as a result of any intentional or negligent act of the client or non-client; or

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[9] Market Integrity Notice 2006-017 - *Guidance – Securities Trading on Multiple Marketplaces* (September 1, 2006) and IIROC Notice 10-0095 – Rules Notice – Guidance Note – UMIR – *Principal Market Determination for 2010* (April 6, 2010).

[10] A "non-client" is a person who is a partner, director, officer or employee of a Participant or a related entity of a Participant that holds an approval from an exchange or self-regulatory entity.

- IIROC has consented to the entry of such order or orders.

If a Participant or Access Person has filed previously at any time a report of an Extended Failed Trade in respect of a principal trade by that Participant or Access Person in a particular security, the Participant or Access Person would not be able to enter an order that on execution would be a short sale without having made arrangements to borrow the securities necessary to settle any resulting trade until IIROC has consented to the entry of the principal order that is a short sale of that particular security. In providing the consent, IIROC will be able to review with the Participant or Access Person the circumstances surrounding the previous Extended Failed Trade and the reasons why the Participant or Access Person believes that future short sales of that particular security are unlikely to fail to settle.

The restriction on future sales by clients and non-clients is broader than for Participants or Access Persons in that it covers short sales of any security and not just the security which was the subject of the Extended Failed Trade. While the Participant is ultimately responsible for the settlement of any failed trade, the Participant may not fully know the reason for the earlier trade failure or the current circumstances of the particular client or non-client. However, the Proposed Amendments provide the Participant with the ability to waive the pre-borrow requirement if the Participant is satisfied, after reasonable inquiry, that the reason for any prior failed trade by the client or non-client was solely as a result of administrative error. Until the Participant is able to complete such an inquiry (or IIROC otherwise consents), the client or non-client would be subject to the pre-borrow requirements on any intended short sale.

Under the Proposed Amendments, a Participant or Access Person who enters an order that would, on execution, be a short sale of a security that IIROC has designated as a "Pre-Borrow Security" would be required to have made arrangements to borrow the securities necessary for settlement of any trade prior to the entry of the order on a marketplace.

As a result of the Proposed Amendments, each Participant and Access Person would have to ensure that they have adequate policies and procedures to regulate the entry of short sales in circumstances when the Participant or Access Person has previously executed an "Extended Failed Trade"[11] or IIROC has designated a security as a "Pre-Borrow Security".

Change in Use of the "Short Exempt" Designation

Presently, the "short exempt" order designation is used to identify an order for the short sale of a security which is not subject to the tick test. If the tick test is repealed as contemplated in the Proposed Amendments, the use of the "short exempt" order designation will no longer be required for this purpose. Under the Proposed Amendments, the existing field on the order entry would be used to indicate an order that is exempt from being marked as "short" (i.e. "short-marking exempt"). Under this proposal, orders from particular accounts for the **purchase or sale** of a security would be designated as "short-marking exempt" upon entry on a marketplace. More specifically, orders would be marked as "short-marking exempt" if the order is from an account that is:

- an arbitrage account which makes a usual practice of buying and selling securities in different markets to take advantage of differences in prices;
- the account of a person with Marketplace Trading Obligations in respect of a security for which that person has obligations; or
- the account of an institutional customer:[12]

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[11] IIROC Notice 11-0080 – Rules Notice – Guidance Note – UMIR – *Implementation Date for the Reporting of Extended Failed Trades* (February 25, 2011) A report of an Extended Failed Trade will be required on or after June 1, 2011 for trades settling through the CNS facilities of CDS. A report for failures of trades settling through the Trade-for-Trade settlement facility of CDS will become effective at a later date once IIROC has completed the development and testing of system that would permit IIROC to receive the information directly from CDS.

[12] Rule 1.1 of the Dealer Member Rules of IIROC provides five broad categories of persons that would be considered "institutional customers" including:

(a) acceptable counterparties as defined in Form 1 - Joint Regulatory Financial Questionnaire and Report ("Form 1");

(b) acceptable institutions as defined in the Form 1;

(c) regulated entities as defined in the Form 1;

(d) registrants (other than individual registrants) under securities legislation; and

(e) a non-individual with total securities under administration or management exceeding $10 million.

In connection with these requirements, IIROC publishes annually a non-exhaustive list of entities which are "acceptable counterparties" and "acceptable institutions". For a link to the most recent listing, see IIROC Notice 10-0229 – Rules Notice – Technical – Dealer Member Rules – *Acceptable Institutions and Acceptable Counterparties Database* (August 25, 2010). See also IIROC Notice 10-0301 – Rules Notice – Technical – Dealer Member Rules – *List of Basle Accord Countries* (November 19, 2010) which identified the 20 countries that then qualified as "Basle Accord Countries" and IIROC Notice 10-0302 – Rules Notice – Technical – Dealer Member Rules – *List of*

- for which order generation and entry is fully-automated,
- which, in the ordinary course, executes both purchases and sales of a particular security on one or more marketplaces on each trading day, and
- which, in the ordinary course, does not have at the end of each trading day more than a nominal position, whether short or long, in the particular security.

IIROC expects that the institutional accounts which would be required to mark orders as "short-marking exempt" would include "high-frequency traders" whose trading strategy does not involve the holding of positions in particular securities.

Use of the "short-marking exempt" designation would relieve the account from having to mark the order as "short". Given the high volume and speed of orders generated by arbitrageurs, market makers and high-frequency traders coupled with the fact that these types of accounts may have orders on both sides of the market on various marketplaces at the same time, determining whether such orders are made from a "long" or "short" position at the time of the entry of additional sell orders is problematic. Use of the "short-marking exempt" designation in the manner proposed would allow IIROC to monitor separately the trading activities of those accounts which are actively buying and selling the same security without taking a directional position in that security and which have a finite time horizon of a trading day or less to effectively balance purchases and sales of the particular security. Further, this revised order marking requirement is intended to permit IIROC to focus monitoring of short sale activity on accounts that have adopted a "directional" position with respect to particular securities. Additionally, IIROC is in the process of introducing an alert in its surveillance system that will be triggered when there is an increase in the level of short selling of an individual security (based on historic levels of short selling activity for that particular security) combined with a significant price decline in the market price of the security. Removing much of the "noise" in the short sale data flowing from trades by persons who are not taking a directional position, regarding the security should permit the alert to operate more effectively.

Concurrent with the issuance of this Rules Notice, IIROC has issued for public comment draft guidance on the use of the "short sale" and "short-marking exempt" order designations that IIROC would intend to issue upon the Proposed Amendments becoming approved and effective.[13] In this Rules Notice, IIROC is also requesting comment on whether the basis for determining whether an order is marked "short" should be changed from the aggregate holdings of the "seller" (across multiple accounts which may in fact be held at multiple Participants or dealers) to the account level which is the level for determining disclosure for short position reports. With the proposed repeal of the tick test, one of the main reasons for using aggregate holdings is removed as there will no longer be a restriction on the price at which the trade may be executed. Changing the basis for determining whether an order is "short" to take into consideration only the holdings in the account entering the sell order at the time the order is entered may simplify the process of determining the appropriate marking while at the same time slightly increasing the proportion of trades which are marked "short".

As an alternative, IIROC had considered the introduction of a separate, new account identifier that would be required for the three types of accounts described above. However, IIROC was of the view that it would be more efficient to reuse the existing "short exempt" designation as marketplaces, service providers, Participants and Access Persons would have to modify their systems to remove functionality and provision for the "short exempt" designation. IIROC specifically seeks comment on the relative merits from an operational perspective for the two approaches.[14]

Consequential Amendments

Definition of "Pre-Borrow Security"

The Proposed Amendments would require a Participant or Access Person to have made arrangements to borrow securities prior to the entry of an order that would, on execution, be a short sale of a security that IIROC has designated as a "Pre-Borrow Security". The Proposed Amendments add a definition of "Pre-Borrow Security" to Rule 1.1 and set out the considerations which IIROC would take into account in making such a designation in an addition to Policy 1.1. In determining whether to make such a designation, IIROC would have to consider whether:

- based on information known to IIROC, there has been an increase in the number, value or volume of failed trades in the particular security by more than one Participant or Access Person;
- the number or pattern of failed trades is related to short selling; and

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Recognized Exchanges and Associations (Regulated Entities Purposes) (November 19, 2010) which identified 31 exchanges and associations the members of which would qualify as "regulated entities".

[13] See IIROC Notice 11-0076 – Rules Notice – Request for Comments – UMIR – *Proposed Guidance on "Short Sale" and "Short-Marking Exempt" Order Designations* (February 25, 2011).

[14] See "Question 5" on page 37 [in the IIROC published version of this Notice].

- the designation helps to maintain a fair and orderly market.

Example of "Manipulative or Deceptive Method, Act or Practice"

With the repeal of the price restrictions on the price at which a short sale may be made, clause (d) of Part 1 of Policy 2.2 which precludes the practice of purchasing a security at a price below the last sale price with the intention of making a short sale at that new lower price would become spent and, as such, the Proposed Amendments would repeal the provision.

Summary of the Impact of the Proposed Amendments

The following is a summary of the most significant impacts of the adoption of the Proposed Amendments:

- Participants and Access Persons would be relieved of the obligation to ensure that short sales complied with the "tick test";
- marketplaces, which have elected to system-enforce the "tick test" for Participants and Access Persons, would be able to remove this functionality from their trading systems;
- each Participant and Access Person would have to ensure that they have policies and procedures that will adequately regulate the entry of short sales in circumstances where the security has been designated a "Pre-Borrow Security" or the Participant or Access Person has previously executed an Extended Failed Trade;
- Participants and Access Persons will need to have made arrangements to borrow securities when undertaking a short sale of:
    - a security that has been designated as a "Pre-Borrow Security",
    - any listed security on behalf of a client or non-client that previously had an Extended Failed Trade in any listed security, or
    - a particular security by the Participant or Access Person acting as principal if the Participant or Access Person has had an Extended Failed Trade in respect of that particular security;
- each Participant would have to ensure that it has adequate policies and procedures to properly identify orders that should be designated as either "short sale" or "short-marking exempt"; and
- each marketplace would have to ensure that its trading systems could correctly handle orders designated as "short sale" or "short-marking exempt".

Technological Implications and Implementation Plan

The technological implications of the Proposed Amendments on Participants, marketplaces or service providers are as follows:

- their systems would have to be able to differentiate between an order designated as "short sale" and "short-marking exempt" (since, under the Proposed Amendments, the designations are mutually exclusive);
- their systems would have to be able to accept the "short-marking exempt" designation on both purchase and sell orders; and
- their system enforcement of the tick test would have to be disabled for orders marked as a "short sale".

IIROC would expect that if the Proposed Amendments are approved by the Recognizing Regulators, the amendments would become effective one hundred and eighty (180) days following the date IIROC publishes notice of the approval.

IOSCO's Four Principles of Short Sale Regulation

Early in 2009, the Technical Committee of IOSCO published a report entitled *Regulation of Short Selling* which contains principles designed to help develop a more consistent international approach to the regulation of short selling. The objective of the report was to help eliminate gaps between the different regulatory approaches to naked short selling while minimising any adverse impact on legitimate activities, such as securities lending and hedging, which IOSCO indicated are critical to capital formation and reducing market volatility.

The report recommends that effective regulation of short selling should be based on the following four principles and the report outlines the minimum actions that regulators should undertake in order to support each of the four principles. A number of "high level" observations on the application of each principle in the Canadian context follow the discussion of each principle. A more detailed analysis of the IOSCO recommendations and their reconciliation to the provisions of UMIR and various procedures and proposals of IIROC are set out in Appendix "C":

IOSCO Principle 1. Short selling activities should be subject to appropriate controls to reduce or minimise the potential risks that could affect the orderly and efficient functioning and stability of financial markets.

In order to reduce or minimise the potential risks from short selling, regulators should have an effective discipline for the settlement of short selling transactions. As a minimum requirement this should impose strict settlement (such as compulsory buy-in) of failed trades.

IIROC Commentary on the Canadian Context: Under UMIR, a Participant or Access Person is engaging in "manipulative and deceptive" activities if on the entry of an order they do not have the reasonable expectation of being able to settle the resulting trade. As such, "naked short selling", as that term is sometimes understood, is not permitted in Canada. Studies by IIROC have demonstrated that, in Canada, a short sale has a lower probability of settlement failure than trades generally and that the primary reason for trade failure is simple "administrative error". Broad mandatory provisions (such as compulsory buy-in) do not exist in Canada.[15] IIROC is in the process of implementing reports on "extended" failed trades (which have not been resolved within 10 days following the scheduled settlement date) which will allow IIROC to follow-up directly on "problematic" trades.[16] IIROC monitors trade failure rates which continued to improve in late 2008 and early 2009 notwithstanding the market turmoil.[17]

IOSCO Principle 2. Short selling should be subject to a reporting regime that provides timely information to the market or to market authorities.

In order to achieve this enhanced level of transparency regarding short selling activity, jurisdictions should consider some form of reporting of short selling information to the market or to market authorities.

IIROC Commentary on the Canadian Context: IIROC recognizes the problems associated with current short position reporting.[18] IIROC proposes to produce and publicly release semi-monthly short sale summaries, based on trading data aggregated across all marketplaces monitored by IIROC for orders marked "short sale".[19] While no one data source can provide a "complete" picture of short sale activity or positions, these semi-monthly trading summaries will provide timely information in a cost efficient manner and will supplement the information available through the semi-monthly short position reports.[20]

IOSCO Principle 3. Short selling should be subject to an effective compliance and enforcement system.

As an effective compliance and enforcement system is essential for an effective short selling regulatory regime, the regulators should:

- *monitor and inspect settlement failures regularly;*
- *consider whether they are able to extend the power to require information from parties suspected of breach, beyond the scope of licensed or registered persons if they lack such power;*
- *establish a mechanism to analyse the information obtained from the reporting of short positions and/or flagging of short sales to identify potential market abuses and systemic risk; and*

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15 All equity trades executed on a marketplace in Canada are cleared and settled through the facilities of CDS. The rules of CDS provide a procedure for the "buy-in" of failed trades. The party that has not received the security purchased may initiate this procedure and, if the failure persists, CDS will, on the instruction of the party that has failed to receive the security, enter orders on a marketplace to close out the position with the additional costs being borne by the defaulting party.

16 See "Implementation of the Report of an 'Extended Failed Trade'" on page 25 [in the IIROC published version of this Notice].

17 See "Trends in Trading Activity, Short Selling and Failed Trades" on pages 30 to 33 [in the IIROC published version of this Notice].

18 For a discussion of the problems and limitations of the current short position reports see "Withdrawal of Proposal to Repeal the Requirement for Short Position Reports" on page 29 [in the IIROC published version of this Notice].

19 IIROC would expect to introduce the semi-monthly trading summaries of short selling activity on marketplaces immediately following the implementation of the Proposed Amendments dealing with the "Short-Marking Exempt" order designation.

20 See "Withdrawal of Proposal to Repeal the Requirement for Short Position Reports" on page 29 [in the IIROC published version of this Notice].

- *review whether their existing cross-border information sharing arrangements are sufficient to facilitate cross-border investigation.*

IIROC Commentary on the Canadian Context: Canada has a "flagging" regime that requires all short sales to be marked as such at the time of entry.[21] Currently, IIROC is able to monitor short selling activity on a timely basis. IIROC is pursuing, in connection with the introduction of a new surveillance and monitoring system, the development of alerts that will be generated by the surveillance system when there is:

- an abnormal increase in short selling activity in a particular security, in comparison to the historical rates for that security; and
- a significant price decline in that security.[22]

This alert will allow IIROC to detect "abusive short selling" activity on a timely basis and to take appropriate remedial or investigative actions including designating the security as being ineligible for further short selling activity. To enhance the effectiveness and operation of this alert, IIROC is also proposing to introduce a "short-marking exempt" designation that will ensure that the "short sale" marker is used only by persons who are taking a directional position in a security when their order is entered.

The "extended failed trade" report will also allow IIROC to monitor the extent to which short selling is involved in failed trades of particular securities.

IIROC monitors trade failure rates generally based on information provided by CDS. IIROC is also co-operating with the OSC in receiving daily CNS trade failure reports from CDS on a daily basis. Access to this database will permit IIROC to determine, from time to time, patterns of failure among Participants and securities.

While IIROC is party to a number of information sharing agreements with foreign self-regulatory organizations and regulators, the securities regulatory authorities have authority in respect of cross-border and domestic investigations involving persons who are outside the jurisdiction of IIROC.

IOSCO Principle 4. Short selling regulation should allow appropriate exceptions for certain types of transactions for efficient market functioning and development.

It is necessary that there is flexibility in short selling regulation in order to allow market transactions that are desirable for efficient market functioning and development. Therefore regulatory authorities should at a minimum clearly define the exempted activities and the manner in which these exemptions should be reported.

IIROC Commentary on the Canadian Context: UMIR presently permits a series of exemptions from price restrictions on short sales for market making and arbitrage activities and for securities, such as inter-listed securities and Exchange-traded Funds, which have a relatively low possibility of abusive short selling due to their relatively high liquidity or relationship with underlying securities. While the Proposed Amendments would repeal price restrictions on short sales, the Proposed Amendments would also separate out, through the use of the "short-marking exempt" order designation, the trading activities of arbitragers, market makers and certain institutional accounts that pursue "directionally neutral" strategies in the trading of securities. The primary purpose of adopting the proposed "short-marking exempt" order designation is to allow IIROC to focus more directly on "directional" short selling activity. A byproduct of the adoption of this new order designation will be an increase in IIROC's ability to monitor the effects, if any, of "non-directional" trading strategies, including high frequency trading.[23]

Short Sale Regulation Initiatives in Other Jurisdictions

Initiatives by the Securities and Exchange Commission

Repeal of Price Restrictions

In July of 2007, the SEC repealed all price restrictions on short sales and precluded self-regulatory organizations from introducing any rules that restricted the price at which a short sale could be made. This action had followed a multi-year "pilot project" which had concluded that price restrictions on short sales had no effect on market prices.

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[21] UMIR exempts the marking of orders by persons with Market Maker Obligations if the order has been automatically generated by the trading system of marketplace.

[22] A "prototype" of the alert is presently in operation and is being monitored to evaluate whether any additional enhancements are desirable to increase the effectiveness of the alert.

[23] See "Change in the Use of the 'Short Exempt' Designation" on pages 11 to 13 [in the IIROC published version of this Notice].

Emergency Order Concerning Short Selling

On July 15, 2008, the SEC issued an "Emergency Order Concerning Short Selling" ("Emergency Order") with respect to 19 listed securities in the United States[24]. Each of the 19 securities covered by the Emergency Order was engaged in the financial services sector in the United States and at the time of the issuance of the order the securities were generally trading at a discount of 70% to 90% from the 52-week high price of the security. At the time of the Emergency Order, only one of the 19 securities was on the "fails" list maintained in accordance with Regulation SHO by the market centre on which the securities were listed. Notwithstanding this fact, the Emergency Order required that a short seller must have entered into an arrangement to borrow the securities required for settlement prior to the execution of the short sale. The Division of Trading and Markets of the SEC provided guidance that "an arrangement to borrow requires more than a [sic] reasonable grounds to believe that the security can be borrowed. An arrangement to borrow means a bona fide agreement to borrow the security such that the security being borrowed is set aside at the time of the arrangement solely for the person requesting the security."[25]

The stated rationale for the Emergency Order was set out in the preamble to the Emergency Order which stated:

> False rumors can lead to a loss of confidence in our markets. Such loss of confidence can lead to panic selling, which may be further exacerbated by "naked" short selling. As a result, the prices of securities may artificially and unnecessarily decline well below the price level that would have resulted from the normal price discovery process. If significant financial institutions are involved, this chain of events can threaten disruption of our markets.
>
> The events preceding the sale of The Bear Stearns Companies Inc. are illustrative of the market impact of rumors. During the week of March 10, 2008, rumors spread about liquidity problems at Bear Sterns, which eroded investor confidence in the firm. As Bear Stearns' stock price fell, its counterparties became concerned, and a crisis of confidence occurred late in the week. In particular, counterparties to Bear Stearns were unwilling to make secured funding available to Bear Stearns on customary terms. In light of the potentially systemic consequences of a failure of Bear Sterns, the Federal Reserve took emergency action.[26]

The Emergency Order was scheduled to terminate on July 29, 2008 but was extended until August 12, 2008.

Other SEC Initiatives

Since September of 2008, the SEC instituted a number of other temporary or permanent initiatives directed at short sales and failed trades, including measures which, among other things:

- extended the Emergency Order to temporarily prohibit all short sales in the publicly traded securities of approximately 800 financial firms (namely banks, saving associations, broker-dealers, investment advisors and insurance companies) identified by the SEC or a self-regulatory organization;[27]
- imposed "enhanced" delivery requirements on sales of all equity securities, by obliging a participant of a registered clearing agency to immediately close out any fail-to-deliver position and prohibiting any further short sales by the participant until a fail-to-deliver position is "closed-out" or a "pre-borrow" is arranged for ("Hard T+3 Close-Out");[28]
- expanded the definition of what constitutes a "manipulative or deceptive device or contrivance" to include any person that deceives a broker-dealer, participant of a registered clearing agency or purchaser about its intention or ability to deliver a security at settlement date (and such person subsequently fails to deliver the security on or before settlement date);[29] and
- imposed additional "reporting" requirements on institutional money managers to, subject to specific exceptions, disclose the number and value of all short sales executed in certain securities on a weekly basis.[30]

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24 SEC Release No. 58166 (July 15, 2008).

25 SEC Division of Trading and Markets - *Guidance Regarding the Commission's Emergency Order Concerning Short Selling* (July 18, 2008).

26 SEC Release No. 58166 (July 15, 2008).

27 SEC Release No. 34-58592 (September 18, 2008). The orders prohibited short sales in financial firms during the period September 18, 2008 to October 8, 2008.

28 SEC Release No. 34-58572 (September 17, 2008). Effective October 17, 2008, the SEC adopted, in substantially the same form, the "Hard T+3 Close-Out Requirement" as an interim final temporary rule (See SEC Release 34-58773).

29 *Ibid.* Effective October 17, 2008, the SEC adopted an antifraud rule, Rule 10b-21 under the *Securities Exchange Act of 1934*, aimed at short sellers (including broker-dealers acting as principal) who deceive specified persons about their intention or ability to deliver securities in time for settlement and that fail to deliver securities by settlement date.

30 SEC Release No. 34-58591 (September 18, 2008).

Short Sale Circuit Breakers

On April 8, 2009, the SEC unanimously voted to seek public comment on whether short sale price restrictions or circuit breaker restrictions should be imposed and whether such measures would help promote market stability and restore investor confidence. The SEC voted to propose two approaches to restrictions on short sales - one being a price test that would apply on a market-wide and permanent basis ("short sale price test") and one that would apply only to a particular security during severe market declines in that security ("circuit breaker").

On February 24, 2010, the SEC adopted Rule 201 which became effective on May 10, 2010 (with implementation originally scheduled for November 10, 2010 but which has been subsequently delayed until February 28, 2011[31]). The rule requires trading centers to establish, maintain and enforce written policies and procedures that are reasonably designed to prevent the execution or display of a prohibited short sale. Generally, equity securities that are listed on a national securities exchange would be covered by the rule. The rule would apply whether the security is traded on an exchange or in the over-the-counter market (such as internally by a dealer and reported on the "tape" using a trade reporting system). If a security declines at least 10% from the closing price on the primary listing market on the previous trading day, a circuit breaker would be triggered and any short sale during the balance of that trading day and the next trading day would have to be entered at a price which is at least one trading increment above the current national best bid.

Observers have noted certain concerns regarding the approach adopted by Rule 201. In particular, Rule 201:

- assumes that a rapid price decline is due to short selling activity;
- in setting the trigger of the circuit breaker at a 10% price decline:
    - does not allow for price declines following an issuer's dissemination of a news release relating to a "negative material change"
    - does not differentiate between types of securities and as a result, the triggering of the circuit breaker will be prevalent for "penny stocks", where a 10% price swing is common;
- anticipates that the restrictions be imposed intra-day "on the fly" in real-time, rather than as an end-of-day process which would be consistent with the existing trading system architecture of most markets;
- does not contemplate any "regulatory follow-up" by a marketplace or a dealer to determine whether the price decline was attributable to "abusive" short selling behaviour;
- does not provide direction on how marketplaces are to handle short sales that are also marked as an "inter-market sweep order" (i.e. a direction by a dealer to a marketplace to immediately execute an order without reference to orders on other marketplaces and for which the dealer has assumed the trade-through obligations under Regulation NMS); and
- contemplates initial projected costs of US$1 billion to the industry and US$1 billion annually thereafter.

Australia

In 2008, the Australian Securities and Investments Commission ("ASIC") announced a package of interim measures relating to short sales.[32] Specifically, these interim measures:

- prohibited naked short sales of all securities which were then currently eligible for "shorting" on the Australian Securities Exchange ("ASX");
- clarified that "covered short sales" will continue to be permitted and provided guidance on which sales will be considered "covered"; and
- introduced a reporting requirement (through the ASX) for covered short sales that continue to be permitted.

The ASIC subsequently prohibited, subject to limited exceptions, all short sales (including "covered" short sales that had been permitted under the interim amendments).[33]

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31 See SEC Release 34-61595 – *Regulation SHO* (February 26, 2010) and SEC Release 34-63247 – *Regulation SHO* (November 4, 2010).

32 ASIC Release 08-204 – *Naked Short Selling Not Permitted and Covered Short Selling to be Disclosed* (September 19, 2008).

33 ASIC Release 08-205 - *Covered Short Selling not Permitted* (September 21, 2008).

The ban on covered short selling for non-financial securities was ultimately lifted, effective November 19, 2008.[34] While the ASIC had initially indicated that the short sale ban respecting financial stocks would only remain in effect until January 27, 2009,[35] the ban was not lifted until May 31, 2009.[36]

The ASIC published a consultation paper on April 30, 2009[37] that sought comments on, among other things, a proposal to permit "naked" short selling in limited circumstances, including those in which a market maker is undertaking hedging practices. Following the consultation process, the ASIC provided some limited exemptions to the outright ban on naked short selling.

The current regulatory framework in Australia includes:[38]

- short sale transaction reporting;
- short sale position reporting where the position is greater than 100,000 or greater than 0.01% of total outstanding securities in the relevant class; and
- subject to certain exemptions, a requirement that a person, when entering a short sale order, has or reasonably believes they have an unconditional ability to settle the transaction.[39]

United Kingdom and European Union

On September 18, 2008, the Financial Services Authority ("FSA") introduced new provisions which prohibit the creation of, or increase in, a net short position giving rise to an economic exposure to shares in specified financial institutions and insurers (including naked and covered short sales). These provisions expired on January 16, 2009. The FSA introduced new short reporting requirements that became effective on September 23, 2008.[40] Under the new reporting regime, a person with a net short position in excess of 0.25% of the share capital in any of the financial issuers affected by the FSA short sale interim amendments, is required to report such position (including any changes in such position) by the following business day ("Disclosure Obligation"). The FSA moved to remove the ban on short sales of financial institutions effective January 19, 2009. At the same time, the FSA also agreed to extend, with minor modifications, the Disclosure Obligation until June 30, 2009.

In February 2009, the FSA published a discussion paper in which it set out its views with respect to the regulation of short sales, including the efficacy of various constraints on short sales, including, "tick tests" and "circuit breakers".[41] The FSA concluded that direct constraints on short selling were not justified at the time; however, in the event of extreme market conditions, some form of emergency intervention may be warranted.

In 2010, the European Commission published a proposal on the regulation of short selling.[42] This proposal includes:

- a two-tier short position reporting requirement with the first tier being a regulatory reporting requirement triggered at 0.20% of issued share capital and the second tier being public disclosure requirement triggered at 0.50% of issued share capital;
- a requirement to mark short orders;
- a requirement that trading venues publish daily information about volumes of short sales that is obtained from the marking of orders;

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34 ASIC Release AD08-65 – ASIC Lifts Ban on Covered Short Selling for Non-Financial Securities (November 13, 2008).

35 ASIC Release 08-210 – *ASIC Extends Ban on Covered Short Selling* (October 21, 2008). The ASIC indicated that concurrent with the anticipated removal of the short sale ban on non-financial securities, the ASIC together with the ASX would be putting in place disclosure and reporting arrangements respecting short sales.

36 The ban on short sales involving financial stocks was extended until March 5, 2009. See ASIC Release 09-05 – *ASIC Extends Ban on Covered Short Selling of Financial Securities* (January 21, 2009). The ban was further extended to May 31, 2009. See ASIC Release 09-36 – *ASIC Extends Ban on Covered Short Selling of Financial Securities* (March 5, 2009).

37 CP 106 – Short Selling to Hedge Risk from Market Making Activities (April 30, 2009).

38 Regulatory Guide 196 – Short Selling – ASIC – published April 2010.

39 The ASIC regulation do not consider a "conditional hold notice" (i.e. a "locate") to constitute an "unconditional ability to settle". However, a legally binding commitment from a lender is considered "unconditional".

40 FSA Statement on Short Positions in Financial Stocks – FSA Public Notice 102 (September 18, 2008). Available at http://www.fsa.gov.uk.

41 FSA Discussion Paper 09/1 – *Short Selling* (February 2009).

42 Proposal for a regulation of the European Parliament and of the Council on Short Selling and certain aspects of Credit Default Swaps – COM (2010) 482.

- a requirements that a person entering into a short sale must have borrowed the securities, entered into an agreement to borrow the securities or have an arrangement with a third party where the third party has confirmed that the securities have been "located" and reserved for lending;

- a requirement that trading venues have adequate arrangements in place for "buy-in" of failed trades, and, in the case of non-settlement, daily fines must be imposed; and

- an authority granted to regulatory authorities to restrict short selling temporarily in response to exceptional situations.

It is anticipated that the regulation would be adopted in mid-2012. In the interim, several European Union Members have adopted, or are in the process of adopting, amendments to their respective short sale regimes both on an interim and permanent basis.[43] While the approaches taken differ from jurisdiction to jurisdiction, the common theme amongst most of the jurisdictions involves adopting measures to enhance the monitoring of short sales. For example, Austria, Greece and Spain have each adopted requirements that require a person to disclose a net short position that exceeds 0.25% of an issuer's outstanding capital.[44]

Hong Kong and Asian Markets

In July 2007, the Hong Kong Stock Exchange ("HKSE") proposed the suspension of price restrictions on short sales. In July 2008, the Hong Kong Securities and Futures Commission ("SFC") approved the proposal to "relax" the uptick rule. However, later in 2008, the SFC, together with the HKSE, announced that in light of recent market developments overseas they had agreed not to implement the July 2008 proposal, and instead, retained the existing regime which limits short sales to "covered" short sales in certain designated securities, at or above the current ask price. pIn 2009, the SFC published a consultation paper concerning the introduction of short position reporting requirements. Proposed legislation, based on the conclusions derived from the consultation process, is expected to include a position reporting requirement where a short position report will be required on a weekly basis once a short position is the lesser of:

- 0.02% of the issued share capital; or

- greater than HK$30 million.

Further weekly reports will be required until the position falls below the reporting threshold.

In July 2008, the Taiwan Stock Exchange removed price restrictions on short sales for a number of securities and the market regulators in both Malaysia and India have moved to ease restrictions on short sales.[45] Of note, on September 30, 2008, the Securities and Exchange Board of India announced that it would not parallel moves by other jurisdictions to prohibit short sales.[46]

Previous Amendments and Previous Proposed Amendments to UMIR

In September of 2007, Market Regulation Services Inc. ("RS") published proposed amendments to the UMIR respecting various aspects of short sales and failed trades that would have:

- repealed the restrictions on the price at which a short sale may be made ("tick test");

- eliminated the requirement to file "Short Position Reports";

- provided a definition of a "failed trade" and require that a report of a "failed trade" be made to a Market Regulator if the reason for the failure is not resolved within ten trading days following the original settlement date of the trade ("Extended Failed Trade");

- provided that the Market Regulator may designate particular securities or class of securities as being ineligible for short selling ("Short Sale Ineligible Security");

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[43] Measures imposed by EU Member Nation regulators prior to September 15, 2010, may continue to apply until July 1, 2013. This means that both the new requirements of the Regulation and disparate national short selling restrictions may remain operative in parallel in various parts of the EU for up to a year. Full harmonisation may not be achieved until July 1, 2013.

[44] Report of the Committee of European Securities Regulators ("CESR") on "Measures Recently Adopted by the CESR on Short Selling" (September 22, 2008).

[45] "Asia Unlikely to Follow U.S. Short Selling Crackdown", Forbes.com (July 25, 2008).

[46] "No Short Sale Ban – Existing Rules Adequate", NewKerla.com (September 30, 2008).

- required that notice be provided to a Market Regulator if, after the execution of a trade, the trade is varied (with respect to price, volume or settlement date) or cancelled; and

- clarified certain requirements that must be met in order for a seller to be considered the owner of securities at the time of a sale.

In May of 2008, in conjunction with the merger of RS with the Investment Dealers Association, the Board ratified and adopted these amendment proposals as IIROC proposals. In October of 2008, at the height of the market turmoil, the Board agreed to defer consideration of the repeal of the tick test and the repeal of the requirement to file Short Position Reports, pending evaluation of further developments in the market and regulatory initiatives instituted in other jurisdictions. The balance of the proposals listed above was approved by the applicable securities regulatory authorities effective October 15, 2008 ("Prior Amendments"). Implementation of the requirement to provide to IIROC a report of an Extended Failed Trade or notice of certain variations or cancellation of trades was deferred and will become effective on June 1, 2011.

Exemption from Price Restrictions on Short Sales for Inter-listed Securities

In light of the SEC's decision in July of 2007 to remove price restrictions on short sales, IIROC granted, effective July 6, 2007, an exemption from the price restrictions on a short sale under Rule 3.1 of UMIR in respect of securities which are inter-listed on an exchange in the United States (the "Inter-listed Exemption").[47] Under the Inter-listed Exemption, if a security is listed on an Exchange and is also listed on an exchange in the United States, a short sale of the security may be entered on any marketplace using the "short exempt" marker. Securities which trade on an ECN in the United States but are not otherwise listed on an exchange in the United States do not qualify for the exemption. The Inter-listed Exemption will continue in force until those aspects of the Proposed Amendments dealing with the repeal of price restrictions on short sales of all securities and the change in use of the "short exempt" order designation have been approved by the Recognizing Regulators or withdrawn by IIROC.

Implementation of the Report of an "Extended Failed Trade"

Securities regulators generally have a concern regarding the relationship between failed trades and preserving market integrity. In order to ensure that the audit trail for any trade is accurate and that IIROC has sufficient information to evaluate whether trading activity has been conducted in compliance with UMIR and other regulatory requirements, the Prior Amendments introduced a requirement that each Participant or Access Person is required to report to IIROC if a trade that has failed to settle on the settlement date remains unresolved 10 trading days following the settlement date. The requirement to file an "Extended Failed Trade" report will become effective on June 1, 2011 with respect to trades other than those using the "Trade-for-Trade" settlement facility of CDS.[48] Implementation of the requirement to file an extended failed trade report had been deferred pending the development and industry testing of the web-based reporting facility. With respect to trades using the "Trade-for-Trade" settlement facility of CDS (which generally represents less than 10% of trades in listed equity securities), the requirement to file an "Extended Failed Trade" report will become effective at a future date once IIROC has completed the programming necessary to allow IIROC to receive directly from CDS information on extended fails in the "Trade-for-Trade" settlement facility of CDS.

These reports of Extended Failed Trades will allow IIROC to determine if the trade has failed to settle for an "improper" reason (for example, if a sale had been executed as an undeclared short sale). Once an initial report of an Extended Failed Trade had been filed with IIROC, the Participant or Access Person will be required to file a second report once the account has cured the default. This reporting regime will put IIROC in a position to monitor trends in Extended Failed Trades, including the steps which a Participant or Access Person may be taking to rectify the default. Information from the reports will be used by IIROC in making a determination whether a particular security should be designated as a "Short Sale Ineligible Security".

The initial Extended Failed Trade report will indicate the steps that have been taken to resolve the "failure" in the preceding 10 business days and which are proposed to be taken to resolve the failure. A "close-out" report is also required to be filed which will indicate the steps which were ultimately taken to resolve the failure. During the period between the initial report and the close-out report, IIROC would be in a position to inquire of a Participant or Access Person as to whether additional steps had been taken since the filing of the initial report. In making such requests, IIROC would rely on its general investigative power under Rule 10.2 of UMIR in the same manner as IIROC does in a review or investigation of other trading activity.

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[47] For a more detailed description of the exemption, reference should be made to Market Integrity Notice 2007-014 - *Guidance – Exemption of Certain Inter-listed Securities from Price Restrictions on Short Sales* (July 6, 2007).

[48] IIROC Notice 11-0080 – Rules Notice – Guidance Note – UMIR – *Implementation Date for the Reporting of Extended Failed Trades* (February 25, 2011).

Implementation of the Report of a Trade Variation or Cancellation

The Prior Amendments introduced a requirement that a trade cannot be cancelled or varied, with respect to price, volume or settlement date, unless the cancellation or variation was made by:

- IIROC in accordance with UMIR; or
- with notice to IIROC immediately following the variation or cancellation of the trade in such form and manner as may be required by IIROC.

The requirement to file a "Trade Variation or Cancellation" report will become effective on June 1, 2011, concurrent with the introduction of the first phase of filing requirements for the Extended Failed Trade reports.[49]

Prior to the settlement of the trade, each Participant or Access Person who is a party to a trade may not agree to a cancellation or variation of the trade (with respect to: the price of the trade; the volume of the trade; or the date for settlement of the trade) except using the procedures and facilities offered by the marketplace on which the trade was executed or the clearing agency through which the trade is or was to be cleared and settled. The use of the procedures and facilities provided by the marketplace or the clearing agency will ensure that information regarding the cancellation or variation can be publicly disseminated. Marketplaces are able to cancel trades in limited circumstances principally related to systems malfunctions or technical problems at the marketplace.

The addition of the notice requirement should not impose, in the ordinary course, a greater administrative burden upon a Participant or Access Person. The current practice to add, vary or cancel trades is for a Participant or Access Person to contact the marketplace on trade date (prior to the trade being reported by the marketplace to CDS) or to contact CDS prior to settlement. If the request has been made to a marketplace, the marketplace will notify IIROC prior to effecting any variation or cancellation. If the request has been made to CDS, CDS reports these variations or cancellations to the marketplace for review and, in turn, the marketplace forwards the report to IIROC. If IIROC concludes that there are no market integrity concerns and agrees with the change, the marketplace amends the official record of the trade. However, if the trade cancellation or variation is made after the settlement of the trade by the clearing agency, notice of the trade cancellation or variation will now be required to be provided to IIROC by each Participant and Access Person that is a party to the trade.

The purpose of the report directly from a Participant or Access Person is to ensure that a trade variation or cancellation is not effected outside the normal processes of the marketplaces and CDS unless IIROC is notified of the variation or cancellation and has the opportunity to review the change for possible market integrity concerns. Notice of a trade cancellation or variation will allow IIROC to ensure that the cancellation or variation of the trade is for a bona fide reason and not as part of a manipulative or deceptive manner of trading (including the establishment of a price that would permit other trading activity to then be conducted in nominal compliance with UMIR or other securities regulatory requirements).

"Short Sale Ineligible Security"

The Prior Amendments allow IIROC to designate a particular security or a class of securities as being ineligible to be sold "short". The purpose of this provision is to provide additional flexibility to IIROC, as the Market Regulator, to respond to developments in trading of a particular security or class of securities if, in IIROC's opinion as concurred in by the applicable securities regulatory authorities, rates of failed trades become excessive.[50] The earlier Amendments also provided an exemption to permit a short sale of a "Short Sale Ineligible Security" if the sale is undertaken in furtherance of Market Maker Obligations or by a derivatives market maker.

The criteria which IIROC would use in pursuing a designation of a security have been specifically set out in Part 4 of Policy 1.1. If, based on reports of failed trades submitted to IIROC in accordance with the requirements of Rule 7.10 or other sources of information, IIROC became aware of systemic failures to settle trades in a particular security or class of securities that were related to short selling activity, the Amendments would permit IIROC to designate the particular security or class of securities as being ineligible for a short sale in the interest of a fair and orderly market. Since studies by IIROC indicated that short selling was not the primary reason for the existence of failed trades, IIROC is of the view that a statistical threshold would not, by itself, be appropriate. IIROC must determine that short selling is exacerbating the situation before deciding whether to seek approval to designate the security as being ineligible for further short selling. IIROC is of the view that there are greater risks to market integrity if a series of dealers experience prolonged trade failures for a relatively minor number of shares of a security that is illiquid than from the failure of a single block trade (due possibly to administrative problems or delays at a custodian) in a highly-liquid security.

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[49] IIROC Notice 11-0079 – Rules Notice – Guidance Note – UMIR – *Implementation Date for the Reporting of Trade Variations and Cancellations* (February 25, 2011).

[50] At the time of the drafting of UMIR, CDNX had Rule C.2.12 which provided: "The Exchange may, whenever it shall determine that market conditions so warrant, prescribe a prohibition on short selling". A comparable provision was not incorporated into UMIR on the grounds that the general provisions curtailing abusive short selling made the provision unnecessary.

In the view of IIROC, the need to make a designation will be a relatively rare occurrence. Since the introduction of UMIR, there has been no instance when either RS or IIROC would have sought approval for such a designation. However, IIROC acknowledges that the repeal of price restrictions on short sales will likely result in increased volatility for less liquid securities. In addition, IIROC acknowledges that junior issuers are concerned with the possibility of "bear raids". IIROC is of the view that the activity which is part of a "bear raid" will be detected with existing monitoring standards employed by IIROC and that such activity may be contrary to existing prohibitions against manipulative and deceptive behaviour.[51] The "Short Sale Ineligible Security" designation is a "backstop" in the event that the repeal of price restrictions on short sales has an unintended impact on short selling activity or if short sales are found to be a principal reason for inordinate "failures" in the settlement of trades in a particular security.

IIROC does not believe that a designation will have to be made in "real time" as the circumstances which will lead to the need to designate a security will build over a period time (e.g. for a particular security, IIROC may see an increasing number of Extended Failed Trade Reports, the issuance of an increased number of "buy-in" notices by CDS, an increasing proportion of short sales, unusual price or volume movements etc.). No one factor would necessarily lead to IIROC determining to seek a designation. Also, it is not possible to provide quantitative "thresholds" for each of the factors that would be taken into account by IIROC. IIROC would consider the circumstances of the particular issuer (e.g. whether the issuer has outstanding securities in respect of which conversion or other rights are tied to the market price of the security or whether the issuer has announced an intention to undertake a significant public offering, private placement or rights offering).

IIROC will only designate a security as a "Short Sale Ineligible Security" with the concurrence of the applicable securities regulatory authorities. IIROC will seek that concurrence in a designation from:

- each securities regulatory authority governing the conduct of trading of a marketplace on which the security is listed or quoted;
- each securities regulatory authority of a jurisdiction in which the issuer of the listed or quoted security is a reporting issuer; and
- each securities regulatory authority that has given notice to IIROC that it wishes to be consulted on a designation.

While IIROC does not believe that a designation will have to be made in "real time", IIROC nonetheless believes that any designation will have to be "timely" in order to address situations arising in the marketplace. If IIROC detects unusual circumstances and concludes that an issue is developing that appears to be rooted in short selling, IIROC's first step would normally be to issue an IIROC Notice indicating that, with respect to the particular security, market participants should ensure their ability to borrow or obtain securities for settlement in advance of any sale.[52] This IIROC Notice would also provide an "early warning" to the applicable securities regulatory authorities that IIROC may seek their concurrence in the designation of a security as being a "Short Sale Ineligible Security". In the meantime, IIROC would continue to monitor trading in the particular security to determine if further regulatory action was warranted.

Under the Prior Amendments, a short sale of a security that is designated as a "Short Sale Ineligible Security" may not be made. The Prior Amendments contained a number of exemptions from this prohibition, including if the order is entered on a marketplace:

- in furtherance of the applicable Market Maker Obligations in accordance with the Marketplace Rules of that marketplace;

[51] Policy 2.2 of UMIR regarding False or Misleading Appearance of Trading Activity or Artificial Price provides that "entering an order for the sale of a security without, at the time of entering the order, having the reasonable expectation of settling any trade that would result from the execution of the order" would constitute a manipulative and deceptive activity. The provision does not require that the dealer make a "positive affirmation" that it has the ability to settle the trade but merely have a "reasonable expectation" at the time of the entry of the order. Essentially, a Participant may enter a short sale of a security until such time as the Participant knows, or should reasonably have known, that it can no longer borrow the securities to effect settlement. Among the activities precluded by Policy 2.2 is the so-called "death spiral" situations. Historically, a "death spiral" had occurred when an issuer was undergoing certain types of arrangements or capital reorganizations (including voluntary or involuntary conversion of debt to a class of listed equity) that tied the conversion or reorganization ratios to the market price of the security to be issued. As the market price of the listed security fell the number of securities to be issued rose. In anticipation of receiving additional listed securities on the completion of the transaction, investors would sell the additional listed security short into the market resulting in further downward pressure on the market price of the listed security. Since the securities that would be issuable on the arrangement or reorganization would not be available to settle the sales in the ordinary course, the sales would be considered "short sales" for the purposes of UMIR.

[52] If the Proposed Amendments are approved, IIROC would formalize the requirement to pre-borrow securities before a short sale if IIROC has designated the security to be a "Pre-Borrow Security". See "Pre-Borrow Requirements" on pages 9 to 11 [in the IIROC published version of this Notice].

- for the account of a derivatives market maker and is entered:
    - in accordance with the market making obligations of the seller in connection with the security or a related security, and
    - to hedge a pre-existing position in the security or a related security;
- as part of a Program Trade in accordance with Marketplace Rules;
- to satisfy an obligation to fill an order imposed on a Participant or Access Person by any provision of UMIR or a Policy; or
- that is of a class of security or type of transaction that has been designated by a Market Regulator.

Withdrawal of Proposal to Repeal the Requirement for Short Position Reports

In October of 2008, IIROC deferred the proposed repeal of the requirement for Participants and Access Persons to prepare and file a short position report on a semi-monthly basis. To replace the aggregation of the information in the short position reports filed by Participants and Access Persons into the CSPR, IIROC envisioned the dissemination, by third parties, of periodic summary reports of short sales executed on marketplaces in particular securities. IIROC continues to encourage marketplaces to make this information publicly available. Nonetheless, IIROC will pursue the introduction of short sale trade summaries on a semi-monthly basis that will correspond to the reporting cycle for short position reports. IIROC expects to begin issuing these semi-monthly summary reports at the same time as the changes to the marking of "short sales" and "short exempt" orders are implemented.

IIROC recognizes that the CSPR has a number of problems and limitations.[53] Nonetheless, IIROC is withdrawing the proposal to repeal Rule 10.10 from further consideration by the Recognizing Regulators. Despite its flaws and in the absence of the ability to readily produce other short sale report at the present time, the CSPR is a "known" report that is comparable to short position reports in other jurisdictions. Furthermore, the continued production and publication of the CSPR supports IIROC's objective of encouraging greater public awareness of short selling in trading activity in Canada. The availability of both trading summaries and the CSPR will allow the current users of the CSPR an opportunity to evaluate the information provided by trading summaries and would provide IIROC with an opportunity to track the relationship between information provided in the CSPR and the marketplace trading summaries.

Summary of Empirical Studies by IIROC

Trends in Trading Activity, Short Selling and Failed Trades

Concurrent with the issuance of this Rules Notice, IIROC has published a statistical study of trends on Canadian marketplaces in the three-year period from May 1, 2007 to April 30, 2010 (the "Study Period") with respect to overall trading activity, short selling and failed trades (the "Trends Study").[54] The Trends Study extended an earlier study undertaken by IIROC for the period May 1, 2007 to September 30, 2008 (the "Prior Study") to also include the nineteen months ending April 30, 2010.[55]

During the Study Period, there was no "negative" change in the pattern of short selling or trade failures from the findings of the Prior Study. In particular, during the Study Period:

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[53] See the discussion under the heading "Short Position Reports" on pages 25 to 27 of Market Integrity Notice 2007-017 – Request for Comments – *Provisions Respecting Short Sales and Failed Trades* (September 7, 2007). In particular, that Market Integrity Notice indicated that:

> Increasingly, there is concern whether the CSPR provides a complete or meaningful picture of the short position in any security. In particular, the CSPR report does not reflect the short position in securities held by:
>
> - US-based or foreign dealers and institutions (which is particularly relevant as approximately 54% of the trading value and 30% of the volume in April of 2007 on regulated marketplaces was undertaken in securities that are inter-listed with the United States);
> - dealers in Canada that are not Participants (e.g. the dealer is not a member of an Excha`nge, user of a QTRS or subscriber to an ATS); and
> - custodians or other institutions in Canada that are members of CDS (and not through an account maintained at a Participant).

[54] IIROC Notice 11-0078 – Rules Notice – Technical - UMIR – *Trends in Trading Activity, Short Selling and Failed Trades* (February 25, 2011).

[55] Reference should be made to IIROC Notice 09-0037 - Administrative Notice – General – *Recent Trends in Trading Activity, Short Sales and Failed Trades* (February 4, 2009).

Trading Activity

- the average number of trades per day increased significantly over the Study Period, with more modest and less consistent increases in average daily volume and value;[56]

- the number of trades in securities listed on the TSX increased throughout the Study Period across all marketplaces trading those securities, with the increase concentrated in the trading of inter-listed securities and ETFs;[57]

- while the number of trades in securities listed on TSXV or CNSX varied significantly throughout the Study Period, the data showed a drop in daily trading volumes from the beginning of the study in 2007 to 2008 with increases in the daily volume from the lows noted in 2008 over the latter part of the Study Period;[58]

- in periods of increased "market stress" ("Market Stress Period")[59] trading activity, as measured by number of trades, exceeded the average for the Study Period;[60]

- securities which were exempt from the tick rule did not decline in price as fast or as far during Market Stress Periods as securities that were subject to the tick rule;[61]

Short Sales

- there was no significant change over the Study Period in the pattern of short selling in comparison with the trading of securities generally;

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[56] The average number of trades per trading day increased from 481,041 in May of 2007 to a high of 1,256,763 in April of 2010 with an average over the Study Period of 841,421 trades per day. Each of the 7 months between October of 2008 and April of 2009 had a number of trades in excess of the Study Period average indicating that the trend towards increased trading activity is continuing notwithstanding the turmoil in the markets generally. For the 17-month period ended September 30, 2008 covered by the Prior Study there were an average of 634,330 trades per day.

With respect to average daily volume, the Study Period average was 700,755,398 with a high of 971,097,043 in April of 2010 and a low of 458,400,292 in August of 2008 (when volume on the TSXV was at a low of 107,602,589). 4 of the 7 of the months between October of 2008 and April of 2009 had volumes in excess of the Study Period average. With respect to average daily value, the Study Period average was $7.37 billion with a high of $9.59 billion in September of 2008 and a low of $5.61 billion in January of 2009. With the exception of October of 2008, the months between October of 2008 and April of 2009 had average daily trade value below the Study Period average (notwithstanding above average number of trades and volume which reflects the general decline in price levels).

[57] The TSX averaged 687,761 trades per day over the Study Period (from a low of 445,945 in May of 2007 to a high of 1,030,801 in October of 2008 (with all 7 of the months between October of 2008 and April of 2009 having a number of trades in excess of the Study Period average). The number of trades in ETFs increased from 3,706 per day in May of 2007 to a high of 39,888 in November of 2008 for an overall average of 13,779 for the Study Period. The number of trades in inter-listed securities increased from 245,175 per day in May of 2007 to a high of 614,047 in March of 2009 for an overall average of 412,225 for the Study Period.

[58] TSXV averaged 25,851 trades per day during the Study Period (with the number of trades declining from 34,944 in May of 2007 to 15,416 trades per day in April of 2008, increasing to 35,484 trades per day by April 2010 with a low of 12,344 trades per day in November of 2008). CNSX averaged 94 trades per day during the Study Period (with the number of trades declining from 152 in May of 2007 to 28 trades per day in April of 2009. Both TSXV and CNSX had below the Study Period average number of trades in each of the 7 months between October of 2008 and April of 2009.

[59] For the purposes of the Prior Study, six of the months (August of 2007 and January, March, July, August and September of 2008) experienced elevated levels of market stress across both indexes. For the purposes of this Study, the months October of 2008 to April of 2009 were included. During the Study Period, the average daily point change in the closing index level of the S&P/TSX Composite was 134.6 points, or 1.201% of the average closing index level (as compared to 129.87 points or 0.958% of the average closing index level found in the period covered by the Prior Study). For the S&P/TSX Venture Composite Index, the average daily point change in the closing index level was 20.87 points or 1.210% of the average closing index level (as compared to 28.94 points or 1.137% of the average daily point change in the closing index level found in the period covered by the Prior Study). The average number of points (and percentage) between the average of the daily high and low index levels for the S&P/TSX Composite was 220.84 points or 1.974% of the daily average of the high/low index level (as compared to 211.43 points or 1.558% of the daily average of the high/low index level found in the period covered by the Prior Study) and, for the S&P/TSX Venture Composite Index, 29.41 points or 1.721% of the daily average of the high/low index level (as compared to 39.88 points, or 1.556%, found in the period covered by the Prior Study). For the purposes of this Study, five months (September of 2008 to January of 2009) experienced elevated level of market stress across both indexes.

[60] The average daily number of trades in a Market Stress Period was 937,013 or approximately 11% above the overall Study Period average of 841,421.

[61] Reference should be made to Chart 2 - *Index Levels Relative to Closing Level on May 1, 2007* in *Trends in Trading Activity, Short Sales and Failed Trade*s.

- the granting in July of 2007 of the exemption from the tick rule for the short sale of an inter-listed security has not had any discernable effect on the pattern or attributes of short sales of inter-listed securities (other than a slight increase in the proportion of trades that are short sales);[62]

- in a Market Stress Period:

    - there is generally a lower than average level of short selling activity on TSXV and CNSX,[63]

    - there is a slightly higher rate of short-selling on the TSX,[64] and

    - the average volume of a short sale of a security (other than a TSXV-listed security) tends to be lower than the volume and value of short sales generally;[65]

- the more "senior" the security, the higher the proportion of short sales;[66]

- short selling activity accounts for a disproportionate level of the trading activity on the transparent ATSs (possibly indicating a concentration of arbitrage and algorithmic trading);[67]

- during the Study Period:

    - two-thirds of issues on the TSX reported a month-end short position, as compared to less than a quarter of the issues on TSXV and one-sixth of the issues on CNSX,

    - short positions in TSXV-listed securities "turned over" faster than for TSX-listed securities,[68]

    - monthly short positions amounted to approximately 13% of trading volume in TSX-listed securities as compared to approximately 1% of trading volume for securities listed on TSXV and CNSX, and

    - the average short position for a security represented the volume of 1,413 average trades on TSX for a TSX-listed security as compared to 13.7 average trades on TSXV for a TSXV-listed security and 1.4 average trades on CNSX for a CNSX-listed security;

Failed Trades

- over the Study Period:

    - the number of failed trades, as a percentage of the overall number of trades, has generally been declining,[69]

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62 For inter-listed securities, short sales generally accounted for between 28% and 35% of trades. With the granting of the exemption from the tick rule, the proportion of short sales in trades of inter-listed securities generally increased to the 35% to 40% range (with a high of 42.2% in February 2010). This increase in the proportion of short sales was anticipated on the granting of the exemption.

63 On the TSXV, short sales accounted for 2.3% of trades in a Market Stress Period as compared to 4.4% throughout the Study Period. On CNSX, short sales accounted for 7.3% of sales in September of 2008 significantly above the Study Period average of 3.5% of trades. However, the averages for the other four months were significantly lower such that the average for a Market Stress Period was only 2.3%.

64 On the TSX, short sales accounted for 27.7% of trades in a Market Stress Period as compared to 28.4% of trades throughout the Study Period.

65 During a Market Stress Period, short sales had an average volume which was generally less than the Study Period average for short sales ranging from 9% less for ETFs, 17% less for inter-listed and 19% for other securities on the TSX and 9% less for securities traded on CNSX. For securities TSXV-listed securities, short sales during a Market Stress Period had a volume 10% higher than the Study Period Average.

66 Over the Study Period, short sales of securities listed on the TSX accounted for 28.4% of trades (33.2% of inter-listed securities, 24.3% of ETFs and 21.5% of other TSX-listed securities) as compared to 4.4% of trades of TSXV-listed securities and 3.5% of trades of CNSX-listed securities.

67 For the "new" marketplaces which publicly display order information, the proportion of short selling ranged from 38.9% of trades on Chi-X, 36.2% of trades on Pure Trading, 27.6% of trading on Alpha to 30.5% of trades on Omega (which during much of the Study Period limited trading to securities which were exempt from the tick rule.) For MATCH Now, which operates as a non-transparent marketplace, short selling accounted for only 13.8% of trades.

68 The turnover rate is determined by dividing the volume of short sales during a month by the outstanding volume of short positions at the end of the month. On average over the Study Period, the short position on the TSX turned over every 0.61 of a month as compared to 0.33 of a month for the TSXV and 0.86 of a month on CNSX.

69 Over the Study Period, "initiated buy-in notices" received by CDS represented 0.22% of trades (ranging from a high of 0.38% in December of 2007 to a low of 0.13% in March of 2008).

- on average, 5.28% of failed trades are closed out through the execution of a "buy-in" on a marketplace, and
- the accumulated value of failed trades, as a percentage of the value of trades, has generally been declining;[70] and

- "market stress" did not increase the rate or value of trade failures.[71]

Prohibition on the Short Sale of Inter-listed Financial Issuers

IIROC had previously published a report entitled "Impact of the Prohibition on the Short Sale of Inter-listed Financial Sector Issuers"[72] which looked at the effect of the imposition of a ban on short selling of inter-listed financial sector issuers between September 22, 2008 and October 8, 2008. That study found that while there were "unusual" levels of activity in "financial sector" issuers in the period leading up to the temporary imposition of a prohibition on short selling, the proportion of short selling of financial sector issuers was generally consistent with historic patterns and the levels of short selling for inter-listed securities. The study concluded that the ban had a significant impact on market quality by reducing liquidity and increasing "spreads" while not having any effect on price volatility.

Price Movement and Short Selling Activity

Concurrent with the issuance of this Rule Notice, IIROC has also published a statistical study that looks at the price movement of securities listed on the TSXV during the Study Period that indicates that the significant price declines observed in the second half of 2008 were not caused by or exacerbated by short selling activity.[73]

Based on the data collected during the Study Period:

- the price of securities traded on the TSXV, all of which were subject to the tick test, fell farther and faster than the price of securities on the TSX which generally were exempt from the tick test;[74] and
- during periods of rapid price decline, short selling activity in TSXV-listed securities declined to levels less than historical averages as measured by:
  - the number of short sales,
  - short sales as a percentage of trades,
  - short sales per issuer, and
  - short position as a percentage of issued capital; and
- during periods of rapid price decline, persons with a "short" position were net "buyers" of TSXV-listed securities.

The data for TSXV-listed securities during the Study Period suggests that:

- the steep price decline observed between July 2008 and December 2008 was neither caused by nor exacerbated by short selling activity; and
- the tick test was not an effective tool to restrict significant and rapid, systemic declines in prices.

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70 Over the Study Period, the value of accumulated fails as a percentage of trade value was 1.67% (ranging from a high of 2.69% in May of 2007 to a low of 0.73% in March of 2009).

71 During the months that were identified as part of a Market Stress Period, the value of accumulated fails as a percentage of trade value was 1.48% or approximately 11% less than the overall average for the Study Period of 1.67% and the proportion of initiated buy-ins as a percentage of trades was 0.17% as compared to 0.24% for the Study Period overall.

72 IIROC Notice 09-0038 – Administrative Notice – General – *Impact of the Prohibition on the Short Sale of Inter-listed Financial Sector Issuers* (February 4, 2009).

73 IIROC Notice 11-0077 – Rules Notice – Technical - UMIR – *Price Movement and Short Sale Activity: The Case of the TSX Venture Exchange* (February 25, 2011).

74 During the Study Period, approximately 64% of the value of securities traded on the TSX were in securities inter-listed between the TSX and an exchange in the United States and were exempt from price restrictions on short sales.

Statistical Study of Failed Trades on Canadian Marketplaces

In 2006, RS undertook a study of failed trades in the Canadian marketplace (the "Failed Trade Study").[75] The Failed Trade Study found that:

- failed trades accounted for 0.27% of the total number of trades executed;
- the more "junior" the marketplace in terms of the type of security traded, the higher the incidence of failed trades;[76]
- special settlement trades experienced a significantly higher rate of failure (6.15% of trades compared to 0.26% for regular settlement trades);
- the predominant cause of failed trades was administrative delay or error[77], which accounted for almost 51% of fails;
- less than 6% of fails resulting from the sale of a security involved short sales;
- fails involving short sales accounted for 0.07% of total short sales;
- "buy-ins" were executed in 4% of failed trades; and
- the average "failed" trade was settled 4.2 days after the "expected settlement date" while 96% of failed trades settled within 10 days after the "expected settlement date".

CSA/IIROC Working Group on Short Selling and Failed Trade Issues

Any proposed changes to UMIR must be approved by the Recognizing Regulators of the CSA. IIROC staff have been participating (and prior to June 1, 2008 staff of both RS and the Investment Dealers Association of Canada participated) in an informal working group with CSA staff (the "Working Group") that has been examining various issues related to failed trades and short sales, including the role that short sales play in the occurrence of failed trades. The Working Group has been monitoring developments related to short sales and failed trades in other jurisdictions, particularly SEC initiatives to amend Regulation SHO.

IIROC has provided the Working Group with periodic updates to the *Recent Trends in Trading Activity, Short Selling and Failed Trades* and other research and studies undertaken by IIROC. The Proposed Amendments by IIROC have been discussed with the Working Group.

Following the publication of this IIROC Notice, the CSA and IIROC are proposing to publish the Joint Notice to solicit feedback on whether additional proposals to enhance disclosure of short sales and failed trades in Canada are required. For example, the Joint Notice may seek comment on whether disclosure of short positions by institutional investors may be necessary, similar to "buy-side" reporting requirements that have been or are being widely implemented in other jurisdictions. The Joint Notice may also seek input on the type, level and frequency of public disclosure of failed trades in equity securities traded on all Canadian marketplaces and cleared through CDS that would be appropriate for the Canadian market.

If significant problems emerge after the implementation of the Proposed Amendments as well as the implementation of any other elements of the IIROC proposal relating to the execution or settlement of short sales, IIROC would be in a position to consider appropriate additional regulatory responses. Similarly, if settlement rates deteriorate after the implementation of the Proposed Amendments, either generally or in specific classes of securities, additional initiatives may be considered by IIROC.

As indicated in the Trends Study, the number of trades executed on marketplaces has increased dramatically over the three-year Study Period from approximately 10,000,000 trades per month to almost 30,000,000 trades while the number of initial buy-in notices received by CDS in connection with trade failures has remained relatively constant, in the range of 30,000 to 40,000

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[75] For a more detailed discussion of the Failed Trade Study and its results, see Market Policy Notice 2007-003 – *General – Results of the Statistical Study of Failed Trades on Canadian Marketplaces* (April 13, 2007).

[76] Rates of trade failure for Study Participants ranged from 0.22% of total trades by Study Participants on the TSX (a total of 838 fails out of 379,211 trades), to 0.90% of trades on TSXV (resulting from 239 fails out of 26,509 trades) and 2.22% of trades on CNQ (resulting from 1 failed trade out of the 45 trades executed on CNQ by Study Participants during the Study Period). The rate of trade failure on CNQ is comparable to the 2.21% rate reported by the SEC Office of Economic Analysis for US Exchange and OTC Bulletin Board securities based on data for May of 2006.

[77] Administrative delays/errors generally include: inadvertent delays related to obtaining physical certificates for securities, custodian lacking instructions and discrepancies related to security price/amount.

notices per month. Studies by IIROC indicated that the majority of trade failures arose out of "administrative error" and were readily resolved. For this reason, a "hard" close-out requirement would have the effect of transferring the cost to dealers that have failed to settle for "innocent" reasons. One proposal considered by IIROC was the introduction of a "capital charge" on the dealer that failed to receive the security which would act as an incentive for that dealer to exercise its buy-in rights. Another option considered was the introduction of an administrative penalty to be imposed on the dealer that failed to deliver. Neither option was pursued, as it was unclear that the adoption of either initiative would have materially reduced the incidence of administrative error, the primary cause of settlement failure. IIROC was of the opinion that, if the underlying patterns for trade failure in Canada showed signs of increasing, a simplified "penalty" would be the preferred option, but that consideration might also be given to a "capital charge" on one or both sides of the failed trade.

One initiative that IIROC noted in a number of jurisdictions was the introduction of a requirement for the reporting of short positions by "holders" of the short position rather than on an aggregate basis by intermediaries, such as dealers and subscribers to an ATS. The CSPR, which is an aggregation of reports filed by Participants and Access Persons, has not proven to be a useful tool to IIROC for monitoring or investigative purposes. Introducing additional account level requirements would not provide information that would be as timely or as meaningful as the enhanced information available through the monitoring of "marked" trades both in real-time time and on post-trade analysis. IIROC has had outstanding since April of 2007 a proposal that would require the unique identifier of each Direct Market Access ("DMA") client to be included with each order, including short sales. This proposal would formalize the practice adopted by marketplaces that require the DMA account identified on the order. The inclusion of DMA account information allows real-time monitoring of account level activity of institutional accounts for all requirements and not just short sales. IIROC's surveillance system provides a comprehensive database for post-trade analysis of all orders and trades on all marketplaces. In the view of IIROC, the monitoring of short sales should be integrated into surveillance systems which already monitor for anomalous price or volume movements in a particular security in real-time. In particular, IIROC is developing an alert which will consider increases in the rate of short selling in conjunction with declines in market price. This alert will help to identify, in real-time, situations that may require regulatory intervention (including the possible designation of the security as a "Pre-Borrow Security" or "Short Sale Ineligible Security"). A position report only provides a snapshot of the situation at a particular point in time and provides no information on the trading activity during the period, which is what impacts market prices. IIROC also noted that the threshold for making a position report in a number of the jurisdictions that have introduced this requirement is 0.25% of the issued capital of the issuer. By comparison, in March of 2009, the average short position in a security listed on TSXV was 0.01% of issued capital (and this is based on the aggregate of gross short positions in all accounts maintained at all Participants).

Questions

While comment is requested on all aspects of the Proposed Amendments, comment is specifically requested on the following questions:

1. Are there any policy reasons, other than those identified in this Request for Comments, that IIROC should consider in pursuing the proposed repeal of the existing "tick test" (short sales must be made at a price not less than the last sale price)? If you disagree with the proposal to repeal the tick test, please indicate why it should be retained.

2. If restrictions on the price of a short sale are to be retained, should UMIR adopt a "bid test" at the time of order entry (e.g. a short order may only be entered on a marketplace at a price above the best bid price)?

3. If restrictions on the price of a short sale are to be retained, whether in the short-term or on a long-term basis, should there be an exemption provided to securities inter-listed on an exchange in the United States?

4. If restrictions on the price of a short sale are repealed, what regulatory arbitrage opportunities may exist in the case of an inter-listed security, where a circuit breaker has been triggered in the United States giving rise to short sale price restrictions? What measures could be taken, if any, to limit this potential regulatory arbitrage?

5. The Proposed Amendments would "reuse" the existing "short exempt" designation to indicate accounts that qualify for the "short-marking exempt" designation. Are there any specific operational considerations for marketplaces or Participants from this change in use? Would there be any benefits to introducing a separate, new designation if marketplaces, service providers and Participants still have to modify their system to remove functionality and provision for the existing "short exempt" designation?

6. Are there any other operational considerations for marketplaces or Participants that would arise as a result of the adoption of the Proposed Amendments, beyond those identified in this Request for Comments?

7. If the Proposed Amendments are approved, IIROC is proposing to delay the implementation for a period of one hundred and eighty (180) days in order to provide Participants, marketplaces and service providers the time to make necessary changes to their systems, policies and procedures. Should the implementation period be longer and, if so, why?

8. The requirement to mark a sell order as a "short sale" is determined based on the aggregate holdings of the "seller" (across multiple accounts which may in fact be held at multiple Participants or dealers) while the requirement of a Participant to file a short position report is based on the position of each individual account. If the tick test is repealed, should the basis for determining the marking orders and filing short position reports be harmonized? Would it be preferable for the marking of orders to be determined based on the holdings in the account entering the sell order at the time the order is entered?

In addition to these questions posed by IIROC, the CSA and IIROC are proposing to publish the Joint Notice to solicit feedback on whether additional proposals to enhance disclosure of short sales and failed trades in Canada are required.

Appendices

- Appendix "A" sets out the text of the Proposed Amendments to UMIR respecting regulation of short sales and failed trades;
- Appendix "B" contains the text of the relevant provisions of UMIR as they would read on the adoption of the Proposed Amendments; and
- Appendix "C" contains the reconciliation of UMIR and proposals to the IOSCO recommendations on the regulation of short sales.

Appendix "A"

Text of Provisions Respecting Regulation of Short Sales and Failed Trades

The Universal Market Integrity Rules are hereby amended as follows:

1. Rule 1.1 is amended by inserting the following definitions of "Pre-Borrow Security" and "short-marking exempt order":

> "Pre-Borrow Security" means a security that has been designated by a Market Regulator to be a security in respect of which an order, that on execution would be a short sale, may not be entered on a marketplace unless the Participant or Access Person has made arrangements to borrow the securities that would be necessary to settle the trade prior to the entry of the order.
>
> "short-marking exempt order" means an order for the purchase or sale of a security from account that is:
>
> (a) an arbitrage account;
>
> (b) the account of a person with Marketplace Trading Obligations in respect of a security for which that person has obligations; and
>
> (c) the account of an institutional customer:
>
> (i) for which order generation and entry is fully-automated,
>
> (ii) which, in the ordinary course, executes both purchases and sales of a particular security on one or more marketplaces on each trading day, and
>
> (iii) which, in the ordinary course, does not have at the end of each trading day more than a nominal position, whether short or long, in the particular security.

2. Rule 3.1 is deleted.

3. Rule 3.2 is amended by:

(a) deleting in clause (a) of subsection (1) the phrase "or subclause 6.2(1)(b)(ix)";

(b) deleting subsection (2) and inserting:

> Clause (a) of subsection (1) does not apply to an order that has been designated as a "short-marking exempt order" in accordance with subclause 6.2(1)(b)(ix).

4. Rule 6.1 is amended by adding the following subsections:

> (3) A Participant acting as agent shall not enter a client order or a non-client order on a marketplace that would, if executed, be a short sale if the client or non-client has previously executed a sale of any listed security that became a failed trade in respect of which notice to the Market Regulator was required pursuant to Rule 7.10 unless:
>
> (a) the Participant has made arrangements for the borrowing of the securities necessary to settle any resulting trade prior to the entry of the order;
>
> (b) the Participant is satisfied, after reasonable inquiry, that the reason for any prior failed trade was solely as a result of administrative error and not as a result of any intentional or negligent act of the client or non-client; or
>
> (c) the Market Regulator has consented to the entry of such order or orders.
>
> (4) A Participant acting as principal or an Access Person shall not enter an order on a marketplace for a particular security that would, if executed, be a short sale if the Participant or Access Person has previously executed a sale in that security that became a failed trade in respect of which notice to the Market Regulator was required pursuant to Rule 7.10 unless:

(a) the Participant or Access Person has made arrangements for the borrowing of the securities necessary to settle any resulting trade prior to the entry of the order; or

(b) the Market Regulator has consented to the entry of such order or orders.

(5) A Participant or an Access Person shall not enter an order on a marketplace for a Pre-Borrow Security that would, if executed, be a short sale unless the Participant or Access Person has made arrangements for the borrowing of the securities necessary to settle any resulting trade prior to the entry of the order.

5. Clause (b) of subsection (1) of Rule 6.2 is amended by:

(a) deleting in subclause (viii) the phrase "which is subject to the price restriction under subsection (1) of Rule 3.1" and substituting the phrase "but not including an order which is designated as a "short-marking exempt order" in accordance with subclause 6.2(1)(b)(ix)"; and

(b) deleting subclause (ix) and substituting the following:

(ix) a short-marking exempt order.

The Policies to the Universal Market Integrity Rules are hereby amended as follows:

1. Policy 1.1 is amended by inserting the following as Part 2.1

Part 2.1 – Definition of "Pre-Borrow Security"

Under the definition of a "Pre-Borrow Security", the Market Regulator may designate a security in respect of which an order that on execution would be a short sale may not be entered on a marketplace unless the Participant or Access Person entering the order has made arrangements to borrow the securities that would be required to settle the trade prior to the entry of the order. In determining whether to make such a designation, the Market Regulator shall consider whether:

- based on information known to the Market Regulator, there is an increase in the number, value or volume of failed trades in the particular security by more than one Participant or Access Person;
- the number or pattern of failed trades is related to short selling; and
- the designation would be in the interest of maintaining a fair and orderly market.

2. Part 1 of Policy 2.2 is amended by:

(a) inserting at the end of clause (b) the word "and";

(b) deleting at the end of clause (c) the phrase "; and"; and

(c) deleting clause (d).

3. Policy 3.1 is repealed.

Appendix "B"

Text of UMIR to Reflect Proposed Amendments Respecting Regulation of Short Sales and Failed Trades

Text of Provisions Following Adoption of the Proposed Amendments	Text of Current Provisions Marked to Reflect Adoption of the Proposed Amendments
1.1 Definitions "Pre-Borrow Security" means a security that has been designated by a Market Regulator to be a security in respect of which an order, that on execution would be a short sale, may not be entered on a marketplace unless the Participant or Access Person has made arrangements to borrow the securities that would be necessary to settle the trade prior to the entry of the order.	**1.1 Definitions** "Pre-Borrow Security" means a security that has been designated by a Market Regulator to be a security in respect of which an order, that on execution would be a short sale, may not be entered on a marketplace unless the Participant or Access Person has made arrangement to borrow the securities that would be necessary to settle the trade prior to the entry of the order.
1.1 Definitions "short-marking exempt order" means an order for the purchase or sale of a security from account that is: (a) an arbitrage account; (b) the account of a person with Marketplace Trading Obligations in respect of a security for which that person has obligations; and (c) the account of an institutional customer: (i) for which order generation and entry is fully-automated, (ii) which, in the ordinary course, executes both purchases and sales of a particular security on one or more marketplaces on each trading day, and (iii) which, in the ordinary course, does not have at the end of each trading day more than a nominal position, whether short or long, in the particular security.	**1.1 Definitions** "short-marking exempt order" means an order for the purchase or sale of a security from account that is: (a) an arbitrage account; (b) the account of a person with Marketplace Trading Obligations in respect of a security for which that person has obligations; and (c) the account of an institutional customer: (i) for which order generation and entry is fully-automated, (ii) which, in the ordinary course, executes both purchases and sales of a particular security on one or more marketplaces on each trading day, and (iii) which, in the ordinary course, does not have at the end of each trading day more than a nominal position, whether short or long, in the particular security.
3.1 Restrictions on Short Selling - *repealed*	~~**3.1 Restrictions on Short Selling**~~ ~~(1) Except as otherwise provided, a Participant or Access Person shall not make a short sale of a security on a marketplace unless the price is at or above the last sale price.~~ ~~(2) A short sale of a security may be made on a marketplace at a price below the last sale price if the sale is:~~ ~~(a) a Program Trade in accordance with Marketplace Rules;~~ ~~(b) made in furtherance of the applicable Market Maker Obligations in accordance with the Marketplace Rules;~~

Text of Provisions Following Adoption of the Proposed Amendments	Text of Current Provisions Marked to Reflect Adoption of the Proposed Amendments
	~~(c) for an arbitrage account and the seller knows or has reasonable grounds to believe that an offer enabling the seller to cover the sale is then available and the seller intends to accept such offer immediately;~~ ~~(d) for the account of a derivatives market maker and is made:~~ ~~(i) in accordance with the market making obligations of the seller in connection with the security or a related security, and~~ ~~(ii) to hedge a pre-existing position in the security or a related security;~~ ~~(e) the first sale of the security on any marketplace made on an ex-dividend, ex-rights or ex-distribution basis and the price of the sale is not less than the last sale price reduced by the cash value of the dividend, right or other distribution;~~ ~~(f) the result of:~~ ~~(i) a Call Market Order,~~ ~~(ii) a Market-on-Close Order~~ ~~(iii) a Volume-Weighted Average Price Order~~ ~~(iv) a Basis Order, or~~ ~~(v) a Closing Price Order;~~ ~~(g) a trade in an Exempt Exchange-traded Fund; or~~ ~~(h) made to satisfy an obligation to fill an order imposed on a Participant or Access Person by any provision of UMIR or a Policy.~~
3.2 Prohibition on Entry of Orders (1) A Participant or Access Person shall not enter an order to sell a security on a marketplace that on execution would be a short sale:	**3.2 Prohibition on Entry of Orders** (1) A Participant or Access Person shall not enter an order to sell a security on a marketplace that on execution would be a short sale:

Text of Provisions Following Adoption of the Proposed Amendments	Text of Current Provisions Marked to Reflect Adoption of the Proposed Amendments
(a) unless the order is marked as a short sale in accordance with subclause 6.2(1)(b)(viii); or (b) if the security is a Short Sale Ineligible Security at the time of the entry of the order. (2) Clause (a) of subsection (1) does not apply to an order that has been designated as a "short-marking exempt order" in accordance with subclause 6.2(1)(b)(ix). …	(a) unless the order is marked as a short sale in accordance with subclause 6.2(1)(b)(viii) ~~or subclause 6.2(1)(b)(ix)~~; or (b) if the security is a Short Sale Ineligible Security at the time of the entry of the order. (2) Clause (a) of subsection (1) does not apply to an order ~~automatically generated by the trading system of an Exchange or QTRS in accordance with the Marketplace Rules in respect of the applicable Market Maker Obligations~~ that has been designated as a "short-marking exempt order" in accordance with subclause 6.2(1)(b)(ix). …
6.1 Entry of Orders to a Marketplace … (3) A Participant acting as agent shall not enter a client order or a non-client order on a marketplace that would, if executed, be a short sale if the client or non-client has previously executed a sale of any listed security that became a failed trade in respect of which notice to the Market Regulator was required pursuant to Rule 7.10 unless: (a) the Participant has made arrangements for the borrowing of the securities necessary to settle any resulting trade prior to the entry of the order; (b) the Participant is satisfied, after reasonable inquiry, that the reason for any prior failed trade was solely as a result of administrative error and not as a result of any intentional or negligent act of the client or non-client; or (c) the Market Regulator has consented to the entry of such order or orders. (4) A Participant acting as principal or an Access Person shall not enter an order on a marketplace for a particular security that would, if executed, be a short sale if the Participant or Access Person has previously executed a sale in that security that became a failed trade in respect of which notice to the Market Regulator was	**6.1 Entry of Orders to a Marketplace** … (3) A Participant acting as agent shall not enter a client order or a non-client order on a marketplace that would, if executed, be a short sale if the client or non-client has previously executed a sale of any listed security that became a failed trade in respect of which notice to the Market Regulator was required pursuant to Rule 7.10 unless: (a) the Participant has made arrangements for the borrowing of the securities necessary to settle any resulting trade prior to the entry of the order; (b) the Participant is satisfied, after reasonable inquiry, that the reason for any prior failed trade was solely as a result of administrative error and not as a result of any intentional or negligent act of the client or non-client; or (c) the Market Regulator has consented to the entry of such order or orders. (4) A Participant acting as principal or an Access Person shall not enter an order on a marketplace for a particular security that would, if executed, be a short sale if the Participant or Access Person has previously executed a sale in that security that became a failed trade in respect of which notice to the Market Regulator was

Text of Provisions Following Adoption of the Proposed Amendments	Text of Current Provisions Marked to Reflect Adoption of the Proposed Amendments
required pursuant to Rule 7.10 unless: (a) the Participant or Access Person has made arrangements for the borrowing of the securities necessary to settle any resulting trade prior to the entry of the order; or (b) the Market Regulator has consented to the entry of such order or orders. (5) A Participant or an Access Person shall not enter an order on a marketplace for a Pre-Borrow Security that would, if executed, be a short sale unless the Participant or Access Person has made arrangements for the borrowing of the securities necessary to settle any resulting trade prior to the entry of the order.	required pursuant to Rule 7.10 unless: (a) the Participant or Access Person has made arrangements for the borrowing of the securities necessary to settle any resulting trade prior to the entry of the order; or (b) the Market Regulator has consented to the entry of such order or orders. (5) A Participant or an Access Person shall not enter an order on a marketplace for a Pre-Borrow Security that would, if executed, be a short sale unless the Participant or Access Person has made arrangements for the borrowing of the securities necessary to settle any resulting trade prior to the entry of the order.
6.2 Designations and Identifiers (1) Each order entered on a marketplace shall contain: … (b) a designation acceptable to the Market Regulator for the marketplace on which the order is entered, if the order is: (i) a Call Market Order, (ii) an Opening Order, (iii) a Market-on-Close Order, (iv) a Special Terms Order, (v) a Volume-Weighted Average Price Order, (v.1) a Basis Order, (v.2) a Closing Price Order, (v.3) a bypass order, (v.4) a directed action order as defined in the Trading Rules, (vi) part of a Program Trade, (vii) part of an intentional cross or internal cross,	**6.2 Designations and Identifiers** (1) Each order entered on a marketplace shall contain: … (b) a designation acceptable to the Market Regulator for the marketplace on which the order is entered, if the order is: (i) a Call Market Order, (ii) an Opening Order, (iii) a Market-on-Close Order, (iv) a Special Terms Order, (v) a Volume-Weighted Average Price Order, (v.1) a Basis Order, (v.2) a Closing Price Order, (v.3) a bypass order, (v.4) a directed action order as defined in the Trading Rules, (vi) part of a Program Trade, (vii) part of an intentional cross or internal cross,

Text of Provisions Following Adoption of the Proposed Amendments	Text of Current Provisions Marked to Reflect Adoption of the Proposed Amendments
(viii) a short sale but not including an order which is designated as a "short-marking exempt order" in accordance with subclause 6.2(1) (b) (ix), (ix) a short-marking exempt order, (x) a non-client order, (xi) a principal order, (xii) a jitney order, (xiii) for the account of a derivatives market maker, (xiv) for the account of a person who is an insider of the issuer of the security which is the subject of the order, (xv) for the account of a person who is a significant shareholder of the issuer of the security which is the subject of the order, or (xvi) of a type for which the Market Regulator may from time to time require a specific or particular designation.	(viii) a short sale ~~which is subject to the price restriction under subsection (1) of Rule 3.1~~ but not including an order which is designated as a "short-marking exempt order" in accordance with subclause 6.2(1) (b) (ix), (ix) a short-marking exempt order ~~sale which is exempt from the price restriction on a short sale in accordance with subsection (2) of Rule 3.1,~~ (x) a non-client order, (xi) a principal order, (xii) a jitney order, (xiii) for the account of a derivatives market maker, (xiv) for the account of a person who is an insider of the issuer of the security which is the subject of the order, (xv) for the account of a person who is a significant shareholder of the issuer of the security which is the subject of the order, or (xvi) of a type for which the Market Regulator may from time to time require a specific or particular designation.
Policy 1.1 – Definitions **Part 2.1 – Definition of "Pre-Borrow Security"** Under the definition of a "Pre-Borrow Security", the Market Regulator may designate a security in respect of which an order that on execution would be a short sale may not be entered on a marketplace unless the Participant or Access Person entering the order has made arrangements to borrow the securities that would be required to settle the	**Policy 1.1 – Definitions** **Part 2.1 – Definition of "Pre-Borrow Security"** Under the definition of a "Pre-Borrow Security", the Market Regulator may designate a security in respect of which an order that on execution would be a short sale may not be entered on a marketplace unless the Participant or Access Person entering the order has made arrangements to borrow the securities that would be required to settle the

Text of Provisions Following Adoption of the Proposed Amendments	Text of Current Provisions Marked to Reflect Adoption of the Proposed Amendments
trade prior to the entry of the order. In determining whether to make such a designation, the Market Regulator shall consider whether: • based on information known to the Market Regulator, there is an increase in the number, value or volume of failed trades in the particular security by more than one Participant or Access Person; • the number or pattern of failed trades is related to short selling; and • the designation would be in the interest of maintaining a fair and orderly market.	trade prior to the entry of the order. In determining whet her to make such a designation, the Market Regulator shall consider whether: • based on information known to the Market Regulator, there is an increase in the number, value or volume of failed trades in the particular security by more than one Participant or Access Person; • the number or pattern of failed trades is related to short selling; and • the designation would be in the interest of maintaining a fair and orderly market.
Policy 2.2. – Manipulative and Deceptive Activities **Part 1 – Manipulative or Deceptive Method, Act or Practice** There are a number of activities which, by their very nature, will be considered to be a manipulative or deceptive method, act or practice. For the purpose of subsection (1) of Rule 2.2 and without limiting the generality that subsection, the following activities when undertaken on a marketplace constitute a manipulative or deceptive method, act or practice: (a) making a fictitious trade; (b) effecting a trade in a security which involves no change in the beneficial or economic ownership; and (c) effecting trades by a single interest or group with the intent of limiting the supply of a security for settlement of trades made by other persons except at prices and on terms arbitrarily dictated by such interest or group. If persons know or ought reasonably to know that they are engaging or participating in these or similar types of activities those persons will be in breach of subsection (1) of Rule 2.2 irrespective of whether such method, act or practice results in a false or misleading appearance of trading activity or interest in the purchase or sale of a security or an artificial ask price, bid price or sale price for a security or a related security.	**Policy 2.2. – Manipulative and Deceptive Activities** **Part 1 – Manipulative or Deceptive Method, Act or Practice** There are a number of activities which, by their very nature, will be considered to be a manipulative or deceptive method, act or practice. For the purpose of subsection (1) of Rule 2.2 and without limiting the generality that subsection, the following activities when undertaken on a marketplace constitute a manipulative or deceptive method, act or practice: (a) making a fictitious trade; (b) effecting a trade in a security which involves no change in the beneficial or economic ownership; and (c) effecting trades by a single interest or group with the intent of limiting the supply of a security for settlement of trades made by other persons except at prices and on terms arbitrarily dictated by such interest or group~~; and~~ ~~(d) purchasing a security with the intention of making a sale of the same or a different number of units of the security or a related security on a marketplace at a price which is below the price of the last sale of a standard trading unit of such security displayed in a consolidated market display~~. If persons know or ought reasonably to know that they are engaging or participating in these or similar types of activities those persons will be in breach of subsection (1) of Rule 2.2 irrespective of whether such method, act or practice results in a false or misleading appearance of trading activity or interest in the purchase or sale of a security or an artificial ask price, bid price or sale price for a security or a related security.

Text of Provisions Following Adoption of the Proposed Amendments	Text of Current Provisions Marked to Reflect Adoption of the Proposed Amendments
Policy 3.1 Restrictions on Short Selling **Part 1 – Entry of Short Sales Prior to the Opening** ***- repealed***	~~**Policy 3.1 Restrictions on Short Selling**~~ ~~**Part 1 – Entry of Short Sales Prior to the Opening**~~ ~~Prior to the opening of a marketplace on a trading day, a short sale may not be entered on that marketplace as a market order and must be entered as a limit order and have a limit price at or above the last sale price of that security as indicated in a consolidated market display (or at or above the previous day's close reduced by the amount of a dividend or distribution if the security will commence ex-trading on the opening).~~
Policy 3.1 Restrictions on Short Selling **Part 2 – Short Sale Price When Trading Ex-Distribution** ***- repealed***	~~**Policy 3.1 Restrictions on Short Selling**~~ ~~**Part 2 – Short Sale Price When Trading Ex-Distribution**~~ ~~When reducing the price of a previous trade by the amount of a distribution, it is possible that the price of the security will be between the trading increments. (For example, a stock at $10 with a dividend of $0.125 would have an ex-dividend price of $9.875. A short sale order could only be entered at $9.87 or $9.88.) Where such a situation occurs, the price of the short sale order should be set no lower than the next highest price. (In the example, the minimum price for the short sale would be $9.88, being the next highest price at which an order may be entered to the ex-dividend price of $9.875).~~ ~~In the case of a distribution of securities (other than a stock split) the value of the distribution is not determined until the security that is distributed has traded. (For example, if shareholders of ABC Co. receive shares of XYZ Co. in a distribution, an initial short sale of ABC on an ex-distribution basis may not be made at a price below the previous trade until XYZ Co. has traded and a value determined).~~ ~~Once a security has traded on an ex-distribution basis, the regular short sale rule applies and the relevant price is the previous trade.~~

Appendix "C"

Reconciliation of UMIR and Proposed Amendments to the IOSCO Recommendations on Regulation of Short Sales

IOSCO Principle/Report Section	Specific Recommendations	Description of UMIR Provisions	
		Existing Provisions	Additional Commentary and Suggested Proposals
Definition	***The Report recognizes that not all jurisdictions consider the same activities to be "short selling". The Report considers "short selling" to be the sale of stock that the seller does not own at the point of sale. The provisions under UMIR differ in the following areas:***	The UMIR provisions contain a more expansive definition of "short sale" than most jurisdictions, including the United States. As a result, the number of short sales will be higher in Canada than would be the case if the definition in the United States applied. In Canada, this means the person making the sale generally must have a "reasonable expectation" of settlement at the time of the sale. In the United States, the sales are treated as "long" even in circumstances when a failure of settlement is contemplated at the time of the sale.	
	Ownership of securities subject to a resale restriction imposed by securities legislation or a marketplace	Sale of any security subject to a resale restriction is a short sale and the seller must have a "reasonable expectation" of being able to settle at time of the sale.	In the US, the sale of certain "restricted" securities is considered a sale from a long position. Even under Rule 204 of Regulation SHO, a dealer is given an additional 36 days following failure to close out the position arising from the sale of certain "restricted" securities.
	Interpretation of "exercise" of option, right or warrant	The holder of an option, right or warrant must have taken all steps to "exercise" the option, right or warrant including the payment of money before the person is considered "long". Similar provisions apply when a person is to acquire securities as a result of "tendering" or "converting".	In the United States, the practice is that securities which are the subject of an option can be sold in the market from a "long" position and the proceeds of sale used to pay for the securities.
	Securities "unavailable" until after settlement date	If securities would, in the ordinary course, not be available until after the scheduled settlement date, the trade is a short sale and the seller must have a "reasonable expectation" of being able to settle at the time of the sale.	The additional restrictions in Canada that apply before a person is considered "long" increase the proportion of short sales and require the Participant to take steps to have a "reasonable expectation" of being in a position to settle. Even under Rule 204, a dealer in the US is given an additional 3 days following failure to close out the position arising from the sale of "unavailable" securities.

IOSCO Principle/Report Section	Specific Recommendations	Description of UMIR Provisions	
		Existing Provisions	Additional Commentary and Suggested Proposals
Principle 1	***Short selling activities should be subject to appropriate controls to reduce or minimise the potential risks that could affect the orderly and efficient functioning and stability of financial markets.***		
3.7	"Effective discipline for settlement of short selling transactions is the first pillar for an effective short selling regime.	If a short sale is made without a "reasonable expectation" of settlement, UMIR provides that the trade constitutes manipulative and deceptive activity contrary to Rule 2.2 of UMIR.	Studies by IIROC found that, in Canada, a short sale was significantly less likely to fail than trades from long positions, generally. In part, this result is due to the fact that short selling is concentrated in those classes of securities with the lowest trade failure rates (senior listed equity securities). Historically, failure rates in Canada have been less than those in the United States. The implementation of Rule 204 significantly reduced US trade failure rates to the extent that US rates may now be less than the prevailing failure rates in Canada. However, studies by IIROC found that failure rates varied significantly amongst securities. "Junior" securities were, for instance, found to have the highest rates. Increases in the proportion of trading accounted for by junior securities since early 2009 have resulted in slightly higher overall failure rates in Canada, without changing the underlying patterns.
3.13	In some jurisdictions, settlement of failed trades achieved by compulsory buy-in or close-out provisions. In some markets, the process is initiated by either the securities settlement system or the buyer who has not received the securities. Some markets impose a monetary penalty.	CDS has "buy-in" provisions which, if initiated by the purchaser who has failed to receive, are mandatory on the defaulting dealer.	As indicated in the studies undertaken by IIROC, the number of trades executed on marketplaces has increased dramatically over the three-year period - May of 2007 to April 2010 - from approximately 10,000,000 trades per month to almost 30,000,000 trades while the number of initial buy-in notices received by CDS in connection with trade failures has remained relatively constant in the range of 30,000 to 40,000 notices per month. Studies by IIROC also indicated that the majority of trade failures arose out of "administrative error" and were readily resolved. For this reason, a "hard" close-out requirement

IOSCO Principle/Report Section	Specific Recommendations	Description of UMIR Provisions	
		Existing Provisions	Additional Commentary and Suggested Proposals
			has the effect of transferring the cost to dealers that have failed to settle for "innocent" reasons. One proposal considered by IIROC was the introduction of a "capital charge" on the dealer that failed to receive the security which would act as an incentive for that dealer to exercise its buy-in rights. Another option considered was the introduction of an administrative penalty to be imposed on the dealer that failed to deliver. Neither option was pursued given the reasons for settlement failure and the rates of failure. IIROC was of the opinion that, if the underlying patterns for trade failure in Canada showed signs of increasing, a simplified "penalty" would be the preferred option but that consideration might also be given to a "capital charge" on one or both sides of the failed trade.
3.14	Encourages the adoption of T+3 as the standard settlement cycle.	T+3 is the standard settlement cycle provided for under UMIR.	Studies by IIROC have indicated that trades which are subject to "special terms", including those related to settlement, have a higher likelihood of settlement failure than "ordinary" trades.
3.16	To support "strict settlement", regulators could adopt eligibility criteria for stocks eligible for short selling, pre-borrowing or 'locate' requirements, price restrictions or "flagging" as appropriate for individual markets.	Under UMIR, all short sales must be "marked" (either as a "short" sale subject to price restrictions or as "short exempt"). UMIR presently provides that a security may be designated as a "Short Sale Ineligible Security" (which precludes any short sale of the particular security subject to certain enumerated exceptions). Unless designated as a "Short Sale Ineligible Security", the security may be sold short.	Given the historic rates of trade failure, studies by IIROC supported the conclusion that general requirements related to "pre-borrowing" or "locate" of securities were not warranted in the Canadian setting. Under the Proposed Amendments, IIROC is proposing to require a pre-borrowing requirement for short sales but its application would be restricted to persons who had executed an "extended failed trade" in any security (i.e. a fail that has persisted for 10 days following the intended settlement date) or in respect of securities with increases in rates of trade failure and short sale activity. While IIROC is proposing to proceed with the repeal of price restrictions on short sales, IIROC is proposing that the existing

IOSCO Principle/Report Section	Specific Recommendations	Description of UMIR Provisions	
		Existing Provisions	Additional Commentary and Suggested Proposals
			"short exempt" marker be used to identify the purchase or sale of a security by an account that is active in the security but essentially, in the ordinary course, aims to be "flat" holdings of a particular security at the end of each trading day (such as arbitrage account, market makers, odd lot dealers and high frequency traders). This would simplify the marking of orders for certain accounts and remove the "chaff" from IIROC's monitoring of short sale activity. (IIROC would also be in a position to monitor the relative buying and selling activity of "short-marking exempt" accounts in a particular security throughout a trading day.)
Principle 2	***Short selling should be subject to a reporting regime that provides timely information to the market or to market authorities.***		
3.17	To achieve "enhanced and meaningful" reporting, should consider reporting short selling information to the market (or at a minimum, to market authorities).	UMIR currently requires the marking of all short sales and this marker is displayed to IIROC but not included in the public display.	IIROC has been pursing the introduction of trading summaries of short sales for particular securities (aggregated by trading activity across all marketplaces trading the security). One of the objectives of providing this information is to demonstrate to the investing public that there are established patterns for different classes of securities (e.g. those included in an "investable" index, underlying interests of a listed option, inter-listed with markets outside of Canada). These patterns reflect hedging, arbitrage and market making activities, together with the liquidity profile of the particular security. IIROC hopes to be in a position by the implementation date of the Proposed Amendments, to publicly provide such reports on a semi-monthly basis. IIROC continues to encourage the marketplaces to publicly provide information on a more frequent basis and ideally in a consolidated report.
3.19	Recognize that information on short selling may mislead the	Attempting to "corner" the market to affect a short	IIROC believes that the important element in short sale data is the

IOSCO Principle/Report Section	Specific Recommendations	Description of UMIR Provisions	
		Existing Provisions	Additional Commentary and Suggested Proposals
	market and expose the seller to a "short squeeze".	squeeze is presently recognized as a manipulative and deceptive activity that is prohibited under UMIR.	underlying pattern or trend. Daily information for a particular security can be distorted by the effects of a small number of trades, particularly with securities of limited liquidity or high volatility. IIROC continues to believe that the "short sale" and "short-marking exempt" flags should not be included in the public order display but must continue to be available to IIROC in real-time.
3.22	Reporting system could be based on "flagging" or "short position" or a comprehensive regime could adopt both models.	IIROC continues to pursue the introduction of trading summaries based on "marked" short sales. UMIR requires that Participants and Access Persons file short position reports on a bi-monthly basis.	In 2007, IIROC had proposed to repeal the requirement for short position reports to be effective following the introduction of an "adequate replacement" (such as the short sale trading summary reports). IIROC is withdrawing the proposed repeal. While the Consolidated Short Position Report is "flawed", relatively costly and cumbersome to compile, IIROC recognizes that the reports are a source of information with an established history. For this reason, the proposed trading summaries of "short sales" for each listed security would be provided semi-monthly to correspond with the reporting period for the Consolidated Short Position Report.
3.23.1	Reporting which excludes derivatives may not provide full picture and "induce a migration of trading activities to the derivatives market".	UMIR does not require information on derivative positions to be included in the short position report.	Information on the outstanding interest in listed derivatives is already publicly available. IIROC acknowledges that there is no source of information on positions subject to over-the-counter derivatives.
3.23.2	Including derivatives would increase complexity and have practical issues associated with collection of derivative data. Recommends assessment of the balance of difficulties and benefits.	UMIR presently exempts from execution on a marketplace transactions related to the exercise of an option or other derivative transaction.	The OSC/CSA have considered proposals to replace the Canadian Unlisted Board with a more comprehensive national trade reporting regime. IIROC has indicated that such an initiative, if IIROC were to act as administrator, could be dovetailed with a more comprehensive reporting of trades of listed securities which have been executed off-marketplace (including on the exercise of OTC derivatives or execution outside of Canada that has not been

IOSCO Principle/Report Section	Specific Recommendations	Description of UMIR Provisions	
		Existing Provisions	Additional Commentary and Suggested Proposals
			reported in that foreign jurisdiction). IIROC does not expect that this initiative will be actively pursued in the foreseeable future.
3.23.3	Recommends consideration of objective and usage of data collected in determining whether reporting of short position on gross or net basis is more appropriate.	UMIR requires the reporting of short positions on a gross basis.	
3.23.5	Trigger level for reporting and frequency of reporting must balance costs of compliance with provision of useful information to "reduce the risk of manipulative and other unfair trading practices".	UMIR does not require "holder" level reporting. When appropriate, this information is obtained from the dealer providing the short position report.	The Consolidated Short Position Report has not proven to be a useful tool for monitoring or investigative purposes. Introducing additional account level requirements would not provide information that was more timely or meaningful than the enhancement of the information available through the monitoring of "marked" trades both in real-time time and on post-trade analysis. IIROC has had outstanding, since April of 2007, a proposal that would require the unique identifier of each Direct Market Access ("DMA") client to be included with each order, including short sales. This proposal would formalize the practice adopted by marketplaces that require the DMA account identified on the order. The inclusion of DMA account information allows real-time monitoring of account level activity of institutional accounts for all requirements and not just short sales. There is also a comprehensive database for post-trade analysis. In the view of IIROC, the monitoring of short sales should be integrated into surveillance systems which already monitor for anomalous price or volume movements in a particular security in real-time. In particular, IIROC is developing an alert which will consider increases in the rate of short selling in conjunction with declines in market price. The alert will help identify in real-time situations that may require further regulatory action (including possible

IOSCO Principle/Report Section	Specific Recommendations	Description of UMIR Provisions	
		Existing Provisions	Additional Commentary and Suggested Proposals
			designation of the security as "Pre-Borrow Security" or "Short Sale Ineligible Security").
3.23.6	Triggers and threshold levels may need to be fine-tuned as more experience is gained.	N/A	The thresholds and triggers proposed or adopted in other jurisdictions do not reflect the divergent patterns of short selling/short positions between marketplaces and classes of securities. For example, the most common proposed threshold is if the short position of a person exceeds 0.25% of issued share capital of the issuer. By comparison, in March of 2009, the average short position in a security listed on the TSX Venture Exchange was 0.010% of issued capital.
3.23.7	Reporting should be done as soon as practicable.	N/A	Studies by IIROC indicated that short selling is not a significant contributing factor in the decline of prices in the Canadian market, even during periods of rapid price decline, such as during the second half of 2008. In fact, short selling and short positions declined dramatically during this period particularly in respect of the "junior" securities which were perceived to be the most vulnerable to short selling abuse.
3.23.8	Reporting should be by the "holder" of the short position (as brokers may not have complete information) but recognize that authorities may not have jurisdiction over the "ultimate" holder.	N/A	The jurisdiction of IIROC is limited to Participants and Access Person and does not extend to investors. However, IIROC continues to believe that the most effective tool to avoid abusive short selling is to monitor trading activity in real-time, so that abusive activity can be detected quickly and regulatory action taken, when appropriate, in a timely manner.
3.25	As brokers are responsible for "flagging", may be easier to monitor compliance with flagging of short sales as compared to short position reporting.	Trade Desk reviews and audits of Participants monitor "marking" and "short position reporting" compliance.	"Holder" level reporting is really only relevant if the shorting activity is of a nature or extent that it is impacting market prices. If such an impact is observed, account level information can be requested from the Participant.
3.26	Flagging may not help in assessing outstanding short positions or large individual	N/A. UMIR currently requires each dealer to prepare a short position report which is	IIROC's ability to identify institutional DMA clients on orders is an important factor in

IOSCO Principle/Report Section	Specific Recommendations	Description of UMIR Provisions	
		Existing Provisions	Additional Commentary and Suggested Proposals
	positions.	aggregated with other reports in the Consolidated Short Position Report.	creating real-time monitoring and the ability to determine trading patterns. IIROC is proposing to withdraw their proposal to repeal the short position report. As such, IIROC will be able to monitor changes in the short positions of individual securities and to then supplement that data with information from the trading summaries.
Principle 3	***Short selling should be subject to an effective compliance and enforcement system.***		
3.28	View that instituting a strict settlement of failed trades "is one of the pillars of a short selling regulatory regime". Regular monitoring and inspections of settlement failures is important, especially for those firms which frequently fail to deliver.	UMIR makes Participant responsible for settlement of each trade and provides that they must have a "reasonable expectation" of settlement at the time of order entry. UMIR will require Participants to report with respect to positions that have not been rectified within 10 days of the intended settlement date.	IIROC monitors trade failure rates generally, based on information provided by CDS. CDS and the OSC are developing a database of daily initial trade failure reports involving the continuous net settlement facilities of CDS. Access to this database would permit IIROC to determine, from time to time, patterns of failure among Participants and securities. IIROC will also be able to establish patterns with respect to "extended failed trades" based on reports filed with IIROC regarding these positions and their resolution. IIROC has set June 1, 2011 as the implementation date of the "extended failed trade reporting" system (other than for trades using the "Trade for Trade" settlement system at CDS which will be implemented at a later date).
3.30	Where there is a "flagging" regime appropriate parties should be required to maintain books and records of short sales for a sufficient period of time.	UMIR requires that order information be retained for a period of seven years and during the first two years the retention must be in a "readily accessible location".	The UMIR requirements complement National Instrument 23-101 requirements which deal with the maintenance of order and trade information not otherwise covered by UMIR (e.g. orders and trades involving derivatives).
3.31	Encourages establishment of a mechanism to analyse the information obtained from flagging or short position reporting to identify potential market abuses and systemic risk.		Historically, IIROC has analysed the data with respect to short sales to establish trends and patterns and has periodically provided the results of this analysis to the securities regulatory authorities and published relevant portions of the

IOSCO Principle/Report Section	Specific Recommendations	Description of UMIR Provisions	
		Existing Provisions	Additional Commentary and Suggested Proposals
			data in reports. IIROC will be introducing a new alert to monitor for a combination of price movement and changes in patterns of short selling. A Surveillance Officer will then be able to determine, in real-time, if abusive short selling is contributing to a significant price decline for a particular security. IIROC has an "unreasonable" price policy under which IIROC may undertake a "regulatory intervention" if there is unreasonable trading or trading which is not in compliance with UMIR. IIROC is proposing to make the policy for regulatory intervention more publicly transparent through the issuance of guidance. The regulatory intervention policy is both general and comprehensive and is triggered by any "unexplained" price movement and not just price declines resulting from short selling activity.
Principle 4	***Short selling regulation should allow appropriate exceptions for certain types of transactions for efficient market functioning and development.***		
3.37	Short selling regulation regime should "not stifle legitimate short selling activities".		Based on the studies and monitoring undertaken by IIROC, it would appear that the perceived abuses that manifested themselves in other jurisdictions were not evident in the Canadian market. IIROC is therefore reluctant to propose additional administrative and regulatory burdens to address problems which do not presently exist. IIROC recognizes that it must continue to monitor trading activity and be in a position to respond (either on its own or in combination with the CSA, CDS and/or marketplaces) should such problems develop in the Canadian context.
3.38	Should be appropriate exceptions for hedging, market	UMIR provides exceptions from price restrictions on short sales	

IOSCO Principle/Report Section	Specific Recommendations	Description of UMIR Provisions	
		Existing Provisions	Additional Commentary and Suggested Proposals
	making and arbitrage. Suggest consideration of whether failed trades arising from market making activities should be allowed more time to settle or be exempt from price restrictions.	for hedging, market making and arbitrage. Additional exceptions are provided for various specialty type orders, Exchange-traded Funds and to satisfy displacement obligations imposed under the "best price" rules of UMIR. Comparable exceptions (other than for specialty orders) apply to the ability to make a short sale of a Short Sale Ineligible Security.	
3.39	While exempted activities may need to be covered by reporting to regulators consideration should be given to exemptions from "public disclosure" to protect interests of parties engaged in the activity.	Under UMIR, the short sale "markings" are not to be included in the public display. However, all "markings" are visible to IIROC for its monitoring activities.	Under the Proposed Amendments, IIROC is proposing a separate "flagging" marker for the purchase or sale by an account that in the ordinary course does not "carry a position" (such as market makers, arbitrageurs and certain institutional accounts that adopt a "directionally neutral" strategy in the trading of securities). This separate category will allow IIROC to monitor the trading activities of this group of persons separate from traditional short selling activity. This separate marking for "short-marking exempt orders" would not be available to the public.
3.40	Exemptions should be clearly defined (particularly in respect of "market making" and "hedging" activities).	UMIR defines "Market Maker Obligations" by reference to Exchange rules. UMIR does not provide exceptions for "informal" market makers. Hedging activities are limited to recognized "derivatives market maker" and "Program Trades" as defined by Exchange rules.	IIROC is presently proposing to replace the definition of "Market Maker Obligations" with a new defined term "Marketplace Trading Obligations" which has been expanded to take into account odd lot and other trading obligations imposed pursuant to a contact between marketplaces and their members or users.