

13.1.4 RS Market Integrity Notice – Request for Comments – Provisions Respecting Short Sales and Failed Trades

September 7, 2007

No. 2007-017

RS MARKET INTEGRITY NOTICE

REQUEST FOR COMMENTS

PROVISIONS RESPECTING SHORT SALES AND FAILED TRADES

Summary

This Market Integrity Notice provides notice that, on August 14, 2007, the Board of Directors of Market Regulation Services Inc. approved the publication for comment of proposed amendments to the Universal Market Integrity Rules respecting various aspects of short sales and failed trades. In particular, the proposed amendments would:

- repeal all restrictions on the price at which a short sale may be made;
- eliminate the requirement to file “Short Position Reports” if adequate information on short sales executed on a marketplace becomes available;
- require that notice must 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;
- provide 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;
- provide that a Market Integrity Official may cancel a “failed trade” under certain circumstances;
- delete provisions for the “short exempt” order marker; and
- clarify certain requirements that must be met for a seller to be considered the owner of securities at the time of a sale.

Questions / Further Information

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PROVISIONS RESPECTING SHORT SALES AND FAILED TRADES

Summary

This Market Integrity Notice provides notice that, on August 14, 2007, the Board of Directors of Market Regulation Services Inc. ("RS") approved the publication for comment of proposed amendments to the Universal Market Integrity Rules ("UMIR") respecting various aspects of short sales and failed trades ("Proposed Amendments"). In particular, the Proposed Amendments would:

- repeal all restrictions on the price at which a short sale may be made;
- eliminate the requirement to file "Short Position Reports" if adequate information on short sales executed on a marketplace becomes available;
- require that notice must 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;
- provide 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;
- provide that a Market Integrity Official may cancel a "failed trade" under certain circumstances;
- delete provisions for the "short exempt" order marker; and
- clarify certain requirements that must be met for a seller to be considered the owner of securities at the time of a sale.

Rule-Making Process

RS has been recognized as a self-regulatory organization by the Alberta Securities Commission, British Columbia Securities Commission, Manitoba Securities Commission, Ontario Securities Commission and, in Quebec, by the Autorité des marchés financiers (the "Recognizing Regulators") and, as such, is authorized to be a regulation services provider for the purposes of National Instrument 21-101 and National Instrument 23-101 (the "CSA Trading Rules").

As a regulation services provider, RS administers and enforces trading rules for the marketplaces that retain the services of RS. RS has adopted, and the Recognizing Regulators have approved, UMIR as the integrity trading rules that will apply in any marketplace that retains RS as its regulation services provider. Presently, RS has been retained to be the regulation services provider for: the Toronto Stock Exchange ("TSX"), TSX Venture Exchange ("TSXV") and Canadian Trading and Quotation System ("CNQ"), each as an Exchange; and for Bloomberg Tradebook Canada Company ("Bloomberg"), Instinet I-X Limited, Liquidnet Canada Inc. ("Liquidnet"), Perimeter Markets Inc. (the operator of "BlockBook") and TriAct Canada Marketplace LP (the operator of "MATCH Now"), each as an ATS. CNQ 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.

The Rules Advisory Committee of RS ("RAC") reviewed the Proposed Amendments. RAC is an advisory committee comprised of representatives of each of: the marketplaces for which RS acts as a regulation services provider; Participants; institutional investors and subscribers; and the legal and compliance community.

The amendments to UMIR will be effective upon approval of the changes by the Recognizing Regulators following public notice and comment and upon ratification of the changes by the Board. Implementation of certain of the Proposed Amendments would be deferred following approval by the Recognizing Regulators until a date determined by the Board to permit changes in the systems and procedures of various market participants. (See "Technological Implications and Implementation Plan".)

The text of the Proposed Amendments is set out in Appendix "A". Comments are requested on all aspects of the Proposed Amendments, including comments on policy alternatives that may be available to the implementation of the Proposed Amendments. Reference should be made to "Specific Matters on Which Comment is Requested". Comments should be in writing and delivered by **October 9, 2007** to:

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

Cindy Petlock
Manager, Market Regulation
Ontario Securities Commission
Suite 1903, Box 55,
20 Queen Street West
Toronto, Ontario. M5H 3S8

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

Commentators should be aware that a copy of their comment letter will be publicly available on the RS website (www.rs.ca under the heading "Market Policy" and sub-heading "Universal Market Integrity Rules") after the comment period has ended. A summary of the comments contained in each submission will also included in a future Market Integrity Notice dealing with the revision or the approval of the Proposed Amendments.

Background to the Proposed Amendments

Current Provisions on Short Selling under UMIR and Provincial Securities Legislation

Section 3.1 of UMIR provides that a Participant or an Access Person may not make a short sale on a marketplace unless the price is at or above the last sale price for that security or unless certain exceptions apply. The price restrictions on short sales imposed by UMIR are not currently dependent on the liquidity of the security or the degree of difficulty of borrowing the security in order to settle the short sale trade. Under the definition of a "short sale" in UMIR, a trade that on settlement will be settled with borrowed securities is considered a short sale.

Provincial securities legislation generally requires a person who places an order with a Participant for the sale of security that person does not own, to declare to the Participant that they do not own the security at the time of the order. The term "short sale" is not a defined term under provincial securities legislation.

The Strategic Review of UMIR's Short Selling Regime

RS launched a strategic review of UMIR (the "Strategic Review") with the issuance of Market Integrity Notice 2004-026 – *Strategic Review of the Universal Market Integrity Rules* (October 4, 2004), which requested public input on which issues RS should consider in the course of the Strategic Review. RS established a series of roundtable discussions in Montreal, Toronto, Calgary and Vancouver with representatives of buy-side and sell-side firms, marketplaces, and law firms.

The respondents at the roundtables who supported the regulation of short sales generally favoured a prohibition of market manipulation, as opposed to price restrictions on short sales. This was in part because of the potential for manipulation through uptick trading (i.e., manipulating the price of a security upwards with purchases of the security). As one respondent noted: "If you're manipulating a stock, you're manipulating a stock. Whether you're buying or selling, it makes no difference, you're manipulating a stock."

There was little support among respondents at the roundtables for importing the US requirement (discussed further below) to locate securities available for borrowing prior to entering a short sale. Many attendees attributed the US requirement to a large number of failures to deliver that have occurred in the US market, which they asserted have not occurred in the Canadian

market.¹ Some sell-side attendees noted that their firms require them to confirm their ability to borrow low-priced or illiquid stocks before entering a short sale.

As part of the Strategic Review, RS undertook a review of the academic literature on short selling. In summary, this review concluded that price restrictions typically act to restrict price discovery by limiting arbitrage and creating overpricing of securities, thus affecting overall market efficiency and liquidity. A number of studies were identified that support the hypothesis that short sale price restrictions impede price discovery by causing securities to be overpriced as investors cannot trade freely on their "negative views". Authors of one Canadian study argued that market efficiency would be improved with less restriction of short sales.

Most of the empirical studies regarding short sales and their exacerbation of market declines have been conducted in the US. These studies have provided little evidence that a US-style price restriction "uptick" rule promotes stability in declining markets.

With regard to market manipulation, there was little literature outside of the US regarding the role of price restrictions in preventing market manipulation. US authors have concluded that the U.S price restriction "uptick" rule is unnecessary in the US for preventing "bear raids" and market manipulation, given the other restrictions and disclosure elements already in place (such as margin and "locate" requirements).

RS recognizes that there are limitations on the applicability of these studies, as they used primarily US market data and did not always use intra-day data. A summary of the literature indicates that tick rules are of limited use in arresting market declines and may have a negative impact on price discovery, which may outweigh any beneficial impact they may have in preventing market manipulation. In fact, the research literature does not provide evidence that a tick test alone prevents market manipulation. This conclusion is consistent with the input of the attendees at the Strategic Review roundtables. The Canadian studies indicate that the costs of short selling are lower in Canada than in the US, which may mean that short selling may be relatively less restricted in the absence of the US-style tick test and locate requirements.

Regulation of Short Selling and Failed Trades in Other Jurisdictions

General

In recent years, securities regulatory authorities in foreign jurisdictions have made a number of changes to their short selling regimes in line with their regulatory views on short selling and its impact upon marketplaces. Each of the regulatory authorities had reviewed their short selling regimes in response to perceived negative effects of short selling upon marketplaces. For example, the United States Securities and Exchange Commission ("SEC"), in the context of its review of short sale regulation and the proposal of Regulation SHO, stated that short selling increases market liquidity and pricing efficiency, but it may be used to illegally manipulate stock prices. It also stated that unrestricted short selling can exacerbate a declining market in a security.

When the United Kingdom's Financial Services Authority ("FSA") reviewed its short selling regulation in 2002 and 2003, it commented that while short selling supports efficient markets, accelerates price correction in overvalued securities, facilitates liquidity and supports hedging activities and derivative trading, it is also risky if the market moves the wrong way, it may lead to disorderly trading and short-term price volatility and may be used in manipulative strategies. The FSA noted a danger of settlement disruption for less liquid stocks and naked shorts and stated that short selling may exaggerate share price declines undermining commercial confidence and fundraising ability. The rules of the London Stock Exchange governing trading on AIM, the venture market, do not include price restrictions on short sales. Instead, member firms must have a "clear strategy for ensuring the settlement of their short positions".²

In 2001 and 2002, the Japan Financial Services Agency and Tokyo Stock Exchange strengthened regulation of short-selling, noting that short selling and short-selling on margin transactions enhance the depth of the market by increasing transaction volume, but may also have "harmful influences".

Regulation SHO

Regulation SHO was adopted by the SEC in 2004 with a compliance date of January 3, 2005. Regulation SHO establishes uniform "locate" and "close-out" requirements. The SEC has stated that these requirements were necessary in order to address problems associated with failures to deliver, including potentially abusive "naked" short selling.

¹ Empirical support for this assertion was found in modelling of a possible Canadian "fails list" undertaken for the CSA/SRO Working Group on Short Selling and Failed Trades. See "CSA/SRO Working Group on Short Selling and Failed Trades Issues". A similar conclusion was reached in research undertaken by RS. See "Statistical Study of Failed Trades on Canadian Marketplaces".

² Rules of the London Stock Exchange, Rule 3300.

Under the "locate requirement", Rule 203(b) of Regulation SHO, with some exceptions, requires a broker-dealer to, before effecting a short sale order in any equity security, either borrow or enter into an agreement to borrow, or have reasonable grounds to believe that the security can be borrowed so that it can be delivered in normal course settlement. This "locate" must be made and documented (an "affirmative determination") prior to effecting the short sale. The "locate" provision places this affirmative determination obligation on all short sellers and applies to both principal and client short sale orders.

Rule 203(b)(3) of Regulation SHO imposes the "close-out requirement", whereby additional delivery requirements are imposed on broker-dealers for securities in which there are a substantial number of delivery failures at a clearing agency ("threshold securities"). The SEC explains that Regulation SHO requires broker-dealers that are participants of a registered clearing agency to take action to "close-out" failure-to-deliver positions ("open fails") that have persisted for 13 consecutive settlement days in threshold securities. "Closing out" requires the broker-dealer to purchase the same kind and quality of securities. Until the position is "closed out", the broker-dealer and any broker-dealer for which it clears transactions may not effect further short sales in that threshold security without borrowing or entering into a bona fide agreement to borrow the security (known as the "pre-borrowing" requirement). "Threshold securities" are equity securities that have an aggregate fail to deliver position for five consecutive settlement days at a registered clearing agency totalling 10,000 shares or more and equal to at least 0.5 percent of the issuer's total outstanding shares.

Under Regulation SHO, threshold security lists must be maintained by either the marketplace itself or the self-regulatory organization that has primary surveillance responsibility for the marketplace. The SEC states that the New York Stock Exchange ("NYSE") and the American Stock Exchange are responsible for calculating and disseminating lists of their respective threshold securities and the National Association of Securities Dealers ("NASD") will maintain and disseminate threshold security lists for NASDAQ, OTCBB and Pink Sheet securities.

It is important to note that Canadian dealers that short sell into the US market must comply with US laws and regulations, including Regulation SHO. The Canadian Depository for Securities Limited ("CDS") currently facilitates the clearing and settlement of transactions between Canadian dealers who are CDS participants and American brokers and institutions. In order to offer these services, CDS is a member of the US National Securities Clearing Corporation ("NSCC") and the Depository Trust Corporation ("DTC"). CDS is the only member of NSCC and DTC; in other words, all of the accounts used to settle cross-border transactions are in the name of CDS, rather than in the name of the individual CDS participants. CDS is consequently subject to US regulations, including Regulation SHO. In order to ensure that CDS participants comply with Regulation SHO in cross-border transactions, CDS amended its rules to include:

- an explicit requirement that a CDS participant who uses CDS for cross-border clearing and settlement services must comply with Regulation SHO;
- a provision allowing CDS to release information to any self-regulatory organization or regulatory body regarding a CDS participant's compliance with Regulation SHO;
- a provision authorizing CDS to restrict a CDS participant's access to cross-border clearing and settlement services where the participant is not compliant with Regulation SHO; and
- a provision mandating that CDS take the necessary steps to close out a CDS participant's "fail-to-deliver" position in a threshold security under Regulation SHO.

SHO Pilot Project

Concurrent with the adoption of Regulation SHO, the SEC initiated a pilot project whereby short sale price restrictions³ were temporarily lifted for a list of 1,000 actively-traded securities and after-hours trading of another list of 1,000 securities (the "SHO Pilot Project"). The securities included in the SHO Pilot Project constituted a sample of securities listed on the NYSE, Nasdaq and American Stock Exchange ("AMEX") and included in the Russell 3000 Index stratified across average daily trading volume levels. The SHO Pilot Project went into effect on May 2, 2005 and has been extended to August 6, 2007, to permit the results of the SHO Pilot Project to be considered in the rule-making process.

The purpose of the SHO Pilot Project is to evaluate the effectiveness and necessity of the price restrictions. In particular, the SEC stated that "the pilot will enable the SEC to obtain empirical data to help assess whether short sale regulation should be removed, in part or in whole, for actively-traded securities, or if retained, should be applied to additional securities."⁴

³ The price restrictions included, for example, the tick test of Rule 10a-1 of the *Securities Exchange Act 1934* and provisions by self-regulatory organizations such as the New York Stock Exchange tick test under NYSE Rule 440B and NASD bid test under NASD Rule 3350.

⁴ SEC Release No. 34-50104, July 28, 2004.

On February 12, 2007 the SEC Office of Economic Analysis (“OEA”) published its report titled *Economic Analysis of the Short Sale Price Restrictions under the Regulation SHO Pilot* (the “SHO Study”).⁵ Among the key findings of the SHO Study was that inclusion of a security in the SHO Pilot Project:

- is associated with increased short selling volume for exchange-listed stocks and Nasdaq National Market stocks⁶, but appears to have no impact on the level of short interest in either market;
- has had no clear effect on market liquidity;
- on average across all types of stocks, does not appear to have any significant effect on daily volatility – however, the results indicate that inclusion is associated with lower volatility for stocks with higher market capitalization, and higher volatility for stocks with lower market capitalization;
- does not provide evidence that the “tick-test” distorts stock prices; and
- is not associated with evidence of “bear raids”.

The SHO Study concluded that the removal of price restrictions on the securities included in the Pilot Project had an effect on the mechanics of short selling, order routing decisions, displayed depth and intraday volatility, but on balance has not had a deleterious impact on market quality or liquidity.

Short Selling and Failures to Deliver in Initial Public Offerings

In April 2007, staff of the OEA published the results of a study of the reasons for “failures to deliver” in connection with trading in equity initial public offerings (“IPO Study”).⁷ In particular, the IPO Study set out to test the hypothesis that failures to deliver during an IPO, and failures to deliver generally, are the result of “naked” short selling. The IPO Study used short selling data from the SHO Study, as well as information collected by OEA staff on transactions involving short sales in connection with 295 IPOs between January 1, 2005 and May 20, 2006.

The results of the IPO study found no evidence that short selling is related to either fails to deliver or to the inclusion of an IPO on the threshold list. OEA staff point out that their findings “present clear evidence questioning the use of fails to deliver to measure naked short selling, even outside the context of an IPO.”⁸

Approved Amendments to Regulation SHO and Short Position Reporting Requirements

On June 13, 2007, the SEC approved various amendments to Regulation SHO and Rule 10a-1, the short sale price test under the *Securities Exchange Act of 1934*⁹, and approved the republication of certain proposed amendments. The approved amendments which had a compliance date of July 6, 2007, include:

- removing short sale price restrictions;
- prohibiting any self-regulatory organization (including any exchange) from having a price test;
- removing “short exempt” order marking requirements; and
- eliminating the “grandfather” exception such that all fail to deliver positions in threshold securities will have to be closed out within 13 consecutive settlement days, regardless of whether the fail occurred before the security became a threshold security.

⁵ *Economic Analysis of the Short Sale Price Restriction under the Regulation SHO Pilot – A Study by the Staff of the Office of Economic Analysis* (Securities and Exchange Commission, Office of Economic Analysis, February 12, 2005). This study is available at: www.sec.gov/spotlight/studies/2007/regshopilot020607.pdf.

⁶ Prior to August 1, 2006, Nasdaq was not operating as an exchange and, therefore, its stocks were not “listed” for the purposes of Rule 10a-1.

⁷ Edwards, Amy K. and Hanley, Kathleen Weiss, (preliminary draft) “Short Selling and Failures to Deliver in Initial Public Offerings” (April 23, 2007). Available at SSRN: <http://ssrn.com/abstract=981242>.

⁸ *Ibid*, p. 27. In part, the IPO Study concludes that IPOs are not as short sale constrained as suggested by the literature and provides evidence that failures to deliver may be related to factors associated with underwriter activities to support the offer price. The IPO Study notes that one explanation for underpricing in IPOs in the academic literature has been that short selling is either difficult or impossible in the immediate aftermarket because of perceived short selling constraints, namely the assumption that shares of newly public companies are difficult to borrow. The IPO Study documents that short selling is prevalent early in the trading of IPOs.

⁹ The amendments were originally proposed as SEC Release No. 34-54891 (December 7, 2006) available at: www.sec.gov/rules/proposed/2006/34-54891.pdf.

The SEC approved the republication of the proposal to remove the exemption of options market makers from the “close-out” requirements of securities on the fail list. The SEC also proposed an amendment to require broker-dealers that are marking a sale as “long” to document the present location of the securities being sold.¹⁰

Based on the results of the SHO Pilot Project and the findings of the SHO Study, the SEC is of the view that removal of all existing price test restrictions would “benefit market participants by providing market participants with the ability to execute short sales in all securities in all market centers”.¹¹ The SEC points out that current short sale regulation applies different price tests to securities trading in different types of markets which may potentially create an un-level playing field between markets and gives rise to regulatory arbitrage by market participants. To this end, the SEC believes that the proposed amendments will reduce confusion, compliance difficulties, and costs for market participants.

At the meeting of the SEC on June 13, 2007, staff of the OEA presented select statistics on the impact of the introduction of Regulation SHO by comparing results from “pre-rule period” (April 1, 2004 to December 31, 2004) to the post-rule period (January 1, 2005 to May 31, 2006). In comparison between the two periods, the number of securities on the threshold list declined by approximately 38% with the average daily volume which failed declining 34% to 534.7 million shares and the average daily volume of securities which are on the fail list declining 52% to 62.7 million shares. However, it is important to note that the statistics reflect only information from NYSE, NASDAQ and Amex and do not include fails from the Bulletin Board. It should also be noted the more “junior” securities traded on the Bulletin Board (2.27% of traded issues) and the Nasdaq Small Cap Market (4.62% of traded issues) were more likely to be included on a fail list than the “senior” securities traded on the exchanges (2.0%).

During the presentation to the SEC, staff noted that there was no evidence that the findings of the Pilot Project would not be applicable to smaller or less liquid securities. However, staff also noted that price volatility was lower among the “large cap” securities that were part of the Pilot Project and higher among the “small cap” securities.

On March 6, 2007, the SEC approved rule amendments submitted by the NASD, NYSE and AMEX, which among other things, increase the frequency of the short interest reporting requirements from monthly to twice per month. The amendments do not otherwise vary the short position reporting requirements, including the type of information to be included in reports.

Recent CSA Initiatives on Trade Matching and Settlement

Earlier this year, the CSA introduced National Instrument 24-101 – *Institutional Trade Matching and Settlement* which provides a general framework for ensuring more efficient and timely settlement processing of trades, particularly institutional trades.¹² The National Instrument, which will become fully effective on October 1, 2007, requires registered dealers and advisers to establish, maintain and enforce policies and procedures designed to achieve matching of delivery against payment or receipt against payment trades as soon as practical after the trade has been executed and in any event no later than the end of the day on which the trade was executed. In addition, the National Instrument requires registered dealers to establish, maintain and enforce policies and procedures designed to facilitate settlement of trades by the standard settlement date.¹³

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

RS staff are participating in an informal working group comprised of staff from the Canadian Securities Administrators (“CSA”), Investment Dealers Association (“IDA”), CDS, TSX and the Bourse de Montréal (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, as part of its mandate, is monitoring developments in the US, including the Pilot Project and the proposals by the SEC to amend Regulation SHO. The Working Group has considered a number of options and proposals related to short sales and failed trades.

In modelling done for the Working Group based on “fail” data provided by CDS from November 2004 to February 2005, the analysis found that a “fail list” developed using thresholds from Regulation SHO (of average fail positions over a five-day period of 10,000 shares or more that constitute 0.5% or more of the issued and outstanding shares of the issuer) would result in an average of 30 issuers on the “fails list”. Based on approximately, 3,894 issues listed on Canadian exchanges at February 28,

¹⁰ The amendments have been proposed as SEC Release No. 34-56213 (August 7, 2007) available at www.sec.gov/rules/proposed/2007/34-56213.pdf.

¹¹ *Ibid.*, p. 43.

¹² (2007) 30 OSCB 335.

¹³ National Instrument 24-101 – Institutional Trade Matching and Settlement, ss 7.1(1). That subsection provides:

A registered dealer shall not execute a trade unless the dealer has established, maintains and enforces policies and procedures designed to facilitate settlement of the trade on a date that is no later than the standard settlement date for the type of security traded prescribed by an SRO or the marketplace on which the trade would be executed.

2005, the application of the US criteria for a fail list would have resulted in less than 0.77% of issuers being on a fail list. Based on the modelling done for the Working Group, if the threshold for inclusion on a "fail list" is dropped to one-half of the level in the United States (10,000 shares or 0.25% or more of the issued capital), a total of 58 issues (or 1.49% of issuers) would have been included on the fail list. Even if the threshold for inclusion on a fails list is dropped to one-half the US level, the proportion of Canadian issuers that would be on a "fail list" would still be a fraction of the US position after the effects of the introduction of Regulation SHO as announced by the OEA.

The modelling done for the Working Group also found that the market value of the fails in the issues on the "fail list" using the US criteria would account for only approximately 12.2% of the market value of all failed trades. If the lower threshold of one-half the US criteria is adopted, the market value of the fails in the issues on the "fail list" would still only account for approximately 19.5% of the market value of all failed trades.

RS questioned the balance between the costs and benefits of a US-style "fail list" for Canadian markets due to:

- the presence of uniform short sale restrictions across all Canadian equity marketplaces removed any link between short sales and failed trades that existed in trading in the United States;
- generally lower rates of trade failure in Canada than the United States; and
- the fact that fails in securities on the fail list accounted for a limited percentage of the value in failed trades.

Statistical Study of Failed Trades on Canadian Marketplaces

In order to respond to the absence of empirical data on the prevalence of fails on Canadian marketplaces, RS undertook to conduct a study of 25 dealers with trading access to a Canadian marketplace ("Study Participant") to gather statistical information on the prevalence of, and the reasons for, failed trades on Canadian marketplaces (the "Study").¹⁴

Study Participants reported a total of 1,078 trades executed on a marketplace monitored by RS¹⁵ that were expected to settle between August 4, 2006 and August 11, 2006 (the "Study Settlement Dates") but failed to do so (the "Study Failed Trades")¹⁶. With respect to these Study Failed Trades the Study found that:

- failed trades accounted for 0.27% of the total number of trades executed by Study Participants on the TSX, TSXV and CNQ¹⁷;
- the more "junior" the marketplace in terms of the type of security traded, the higher the incidence of failed trades;¹⁸
- Bank-owned Participants and Non-Bank Participants displayed relatively comparable patterns of failed trades;¹⁹
- special settlement trades experienced a significantly higher rate of failure (6.15% of trades compared to 0.26% for regular settlement trades); and
- in relation to total trades by account type, failed trades were distributed proportionately across retail client accounts, institutional accounts (including Direct Market Access accounts) and "pro" and inventory accounts in accordance with overall trading activity.

¹⁴ For a more detailed discussion of the 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).

¹⁵ For the period covered by the Study Settlement Dates, both Bloomberg and Liquidnet operated as order routers and did not execute trades in listed securities. As such, Bloomberg and Liquidnet were excluded from the analysis.

¹⁶ Participants reported an additional 27 failed trades that were excluded from the analysis as 15 of the failed trades occurred on marketplaces outside of Canada and 12 of the failed trades involved an "off-marketplace" private placement or transaction.

¹⁷ BlockBook did not execute any trades in the period August 1 to August 8 that would otherwise settle on a Study Settlement Date and therefore BlockBook was excluded from the analysis.

¹⁸ 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.

¹⁹ Non-Bank Participants displayed a rate of trade failures in respect of trading on the TSXV which was more than twice the rate for Bank-owned Participants.

Of the 1,078 Study Failed Trades, Study Participants provided more detailed information on a random sample of Study Failed Trades comprising a total of 373 Detailed Analysis Failed Trades.²⁰ The Study found that, based on the Detailed Analysis Failed Trades:

- the predominant cause of failed trades was administrative delay or error²¹, 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 only 0.07% of total short sales;
- “buy-in” procedures were used in only 4% of failed trades; and
- approximately 88% of failed trades settled within 5 days after the “expected” settlement date, 96% within 10 days and fully 98% within 15 days after the “expected” settlement date.

During the Study Period, approximately 24% of sales made by Study Participants were short sales, yet the Study found that only 6% of fails resulting from the sale of a security involved a short sale. This finding is at odds with the presumption underpinning the “fail list” provisions in the United States which further restricts short sales when a security passes the threshold on “fails” and is added to the fails list.

Summary of the Proposed Amendments

The following is a summary of the principal components 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”. RS recognizes that, in the absence of an information processor, trade information disseminated by certain marketplaces is not readily incorporated into data feeds provided by other information vendors. As such, there are practical difficulties for a Participant or Access Person to monitor affected orders to ensure compliance with the requirements of Rule 3.1. The trading systems of certain of the marketplaces have been designed to “system enforce” the price restriction on short sales. If trade information from all marketplaces is not available in a timely manner in a form that can be readily incorporated into the working of the trading system, the trading systems can not accurately restrict short sales at prices that will comply with the requirements of Rule 3.1.

RS set out in Market Integrity Notice 2006-017 *Guidance – Securities Trading on Multiple Marketplaces* (September 1, 2006) an administrative interpretation that would allow a Participant or Access Person, as applicable, when determining the “last sale price” of a particular security to rely on trade information from the “principal market” for the trading of that security or, when trading on another marketplace, the last sale price on that other marketplace provided such trade on that other marketplace has been executed subsequent to the last sale on the principal market. RS recognizes that the ability to execute short sales on a marketplace other than the principal market at a price lower than the last sale price on the principal market may act as an inducement to direct short selling activity away from the principal market. However, RS believed that this interpretation was supportable during the initial period following the introduction of multiple competitive marketplaces while a more thorough review was undertaken of all provisions governing the conduct of a short sale on a marketplace.

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.

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. The marking of orders would permit RS to monitor the effect of the short sales on market price and to intervene if it appeared that the short sales were being undertaken for a manipulative and deceptive purpose or any other improper purpose. The continued requirement to mark orders as “short” is central to the proposal of replacing the Consolidated Short Position Report. (See “Short Position Reports”.)

²⁰ Of the Study Failed Trades on which additional detail was submitted by Study Participants, 3 of the trades were excluded from further analysis as the failed trade involved a margin account.

²¹ Administrative delays/errors generally include: inadvertent delays related to obtaining physical certificates for securities, custodian lacking instructions, and discrepancies related to security price/amount.

As noted above, academic literature and studies by the SEC have confirmed that the elimination of price restrictions on short sales will result in lower price volatility for “large cap” securities and higher volatility for “small cap” securities. As such, the removal of the price restrictions on short sales should have a minor effect on the monitoring of trading activity on the TSX as 91.2% of trades on the TSX in March and April of 2007 occurred in securities that would qualify as a “highly-liquid security”. On the other hand, during this period only 24.6% of trading on the TSXV and none of the trading on CNQ was in a security that qualified as a “highly-liquid security” under the UMIR definition. The tendency for increased price volatility for the illiquid securities on the TSXV and CNQ would be mitigated by the operation of the market making system that requires market makers to maintain a two-sided market within agreed upon spread goals. In addition, TSX, TSXV and CNQ maintain “price parameters” which temporarily “freezes” trading activity in a security if price movement from the last sale price exceeds certain pre-determined amounts.

The less liquid the market the greater the relative effort that is required to monitor the trading activity for compliance with market integrity rules. Given the proportion of trading accounted for by highly-liquid securities on each market, the removal of price restrictions on short sales should have only a minor impact on the generation of statistical trading alerts in respect of trading activity on the TSX. On the other hand, the increased volatility for the majority of securities on the TSXV could be expected to result in a greater number of statistical trading alerts. The additional alerts that are generated should identify possible circumstances of manipulative and deceptive trading practices. However, it must be recognized that the increased generation of alerts with less liquid securities may mean that the costs of regulating “junior” markets may increase with the changes in alert generation.²²

Alternatives Considered

The original policy rationale for the price restrictions on short sales was to preclude undue downward pressure on the trading price of a particular security from “sellers” who do not own the security. RS recognizes that, in response to the findings of the SHO Study, the SEC has eliminated price restrictions on short sales generally.²³ Staff of RS was of the view that the results of the SHO Study should be applied with caution in the Canadian context given:

- the significant differences in market capitalization and liquidity for securities included in the Russell 3000 index in the United States and securities listed on CNQ, TSXV and even a significant number of securities listed on TSX²⁴;
- the time period covered by the SHO Study was a period of rapidly expanding volumes and number of trades²⁵; and
- index levels have to date generally increased throughout the period of the SHO Study and there was no serious “market stress” event during the period of the SHO Study.²⁶

²² During April of 2007, a statistical trade alert was generated for every 412.3 trades on the TSX as compared to every 24.9 trades on the TSXV. The extent of the impact on alert generation between each of the existing marketplaces can not be accurately predicated.

²³ The amendments by the SEC would preclude the application of restrictions on the price of short sales of the approximately 67,000 issuers the securities of which are traded over-the-counter and which were not otherwise subject to the price restrictions of Rule 10a-1.

²⁴ For example, as at April 30, 2007, the average market capitalization of an issuer included in the Russell 3000 Index was \$84.648 billion (US\$) and a median market capitalization of \$1.201 billion (US\$). By way of comparison, the market capitalization of the largest constituent of the S&P/TSX Composite Index as at April 30, 2007 was approximately \$73.713 billion (Cdn\$). The average market capitalization of a constituent of the S&P/TSX 60 Index was approximately \$1.352 billion (Cdn\$) and a median market capitalization of approximately \$1.899 billion (Cdn\$). For April of 2007, the TSX reported an annualized turnover rate of 77.6% as compared to a turnover rate of 114% for NYSE Group (including NYSE Arca). For April of 2005, the TSX Group reported an annualized turnover rate of 63.3% as compared to 120% for the NYSE Group.

²⁵ For example, in April of 2007, trading on the TSX had a value of \$124.2 billion and volume of 7.9 billion shares resulting from 8,357,352 trades. In April of 2005, trading on the TSX had a value of \$75.3 billion and volume of 4.45 billion shares resulting from 3,649,847 trades. By comparison, in April of 2007, trading on the NYSE had a value of \$1,956 billion (US\$) and volume of 47.9 billion shares resulting from 139,720,720 trades. In April of 2005, trading on the NYSE had a value of \$1,554 billion (US\$) and volume of 45.3 billion shares resulting from 77,745,000 trades.

²⁶ In the period May of 2005 to April of 2007, the Russell 3000 Index increased by approximately 16.24% annualized return. By way of comparison, the S&P/TSX Composite Index increased from 9,369.3 at the close at the end of April 2005 to 13,416.7 at the close on April 30, 2007, an annualized increase of approximately 20%.

In particular, RS would note the differences in liquidity for listed securities between TSX, TSXV and CNQ in comparison with the liquidity for securities listed on the NYSE.

| Marketplace | Period / % Change | Listed Issues | Daily Average Per Listed Issue | | |
|-------------|-------------------|---------------------|--------------------------------|---------|--------|
| | | | Value | Volume | Trades |
| TSX | Apr. 2005 | 1,862 | \$1,925,470 | 113,864 | 93.3 |
| | Apr. 2007 | 2,104 | \$2,950,511 | 188,983 | 198.5 |
| | % Change | 13.0% | 53.2% | 66.0% | 112.8% |
| TSXV | Apr. 2005 | 2,023 | \$24,069 | 32,645 | 5.5 |
| | Apr. 2007 | 2,277 | \$105,676 | 112,989 | 18.7 |
| | % Change | 12.6% | 339.1% | 246.1% | 240.4% |
| CNQ | Apr. 2005 | 44 | \$5,732 | 20,448 | 1.4 |
| | Apr. 2007 | 73 | \$13,147 | 21,192 | 2.0 |
| | % Change | 65.9% | 129.4% | 3.6% | 42.9% |
| NYSE Group | Apr. 2005 | 2,707 ²⁷ | \$27,336,535 (US\$) | 796,825 | 1,377 |
| | Apr. 2007 | 2,782 ²⁷ | \$35,146,118 (US\$) | 860,644 | 2,511 |
| | % Change | 2.8% | 17.59% | 8.0% | 82.4% |

To address these concerns, particularly with respect to the trading of securities with limited liquidity, RS is proposing to undertake an empirical study of the impact of the repeal of the price restrictions on short sales and the other changes included in the Proposed Amendments on:

- trading activity;
- rates of failure in the settlement of trades; and
- the ability to detect manipulative or deceptive trading in circumstances when abusive short selling has occurred.

For more details on the proposed study, see “Impact Study” under the heading “Technological Implications and Implementation Plan”.

Staff of RS had considered several changes to the current price restriction regime as alternatives to the outright repeal of the price restrictions. Among the changes considered by staff were:

- expanding the classes of securities that would be exempt from price restrictions; and
- simplifying the means of determining the price below which a short sale was not able to be made.

Additional Exemptions

RS staff considered expanding the list of securities that would be exempted from the price restrictions on short sales to include a “highly-liquid security” or a security that had been designated by RS. The exemption for a “highly-liquid security” would have paralleled the similar exemption from price restrictions on market stabilization and market balancing activities under Rule 7.7. The policy rationale underpinning such an exemption is that it is difficult to manipulate the price (either upward in the case of market stabilization or market balancing or downward in the case of a short sale) of a security that is sufficiently liquid.

As at April 30, 2007, there were a total of 463 listed securities which qualified as a “highly-liquid security” of which 430 were listed on the TSX (representing 20.4% of the 2,104 issues then listed on the TSX) and 33 on TSXV (representing only 1.4% of the 2,277 issues then listed on TSXV). However, the securities listed on the TSX which qualified as a “highly-liquid security” as at April 30, 2007 accounted for approximately 91.2% of trades on the TSX during March and April of 2007 and approximately 96.0% of the value of trades on the TSX during the same period. The securities listed on the TSXV which qualified as a “highly-liquid security” as at April 30, 2007 accounted for approximately 24.6% of trades on the TSXV during March and April of 2007 and approximately 37.5% of the value of trades on the TSXV during the same period. The introduction of an exemption for a “highly-liquid security” would have permitted short sales in securities which account for the over-whelming majority of trading activity on the TSX and a significant proportion of the trading activity on TSXV. Price restrictions on short sales would have

²⁷ Based on listings as at December 31st.

continued to apply to those securities listed on the TSX, TSXV and CNQ which are less liquid and hence more susceptible for “artificial” or “undue” price influences.

RS staff also considered providing that RS could designate additional securities as exempt from the price restrictions in appropriate circumstances. In particular, staff recognized that if liquidity on Canadian marketplaces continued to expand such that enhanced liquidity will be a “permanent” feature of marketplaces (as a result of such factors as: increased direct access for institutional and retail clients; greater reliance on algorithmic trading; and increased arbitrage activity between competitive marketplaces), there may be merit in designating all listed securities as exempt from price restrictions for short sales (and dealing with the possible misuse of short sales through rules dealing with manipulative and deceptive activities).

The advantage of this approach was that it did not expose illiquid securities to undue selling pressure thereby eliminating the need to monitor short sales made below the last sale price for manipulative or deceptive effects. However, in the view of RS, the existing RS-system monitors for manipulative and deceptive behaviour are robust enough to adequately deal with any short selling at prices which were previously precluded by virtue of Rule 3.1.

The disadvantages of this approach relate principally to systems implications and on-going compliance costs. Each of the current marketplaces system-enforces compliance with the price restrictions on short sales. Implementation of this alternative would have required significant programming on the part of marketplaces with a requirement to monitor the securities which qualified as a “highly-liquid security”. If one or more marketplaces chose not to system enforce the price restrictions, the burden would have shifted to Participants and Access Persons (or their service providers). In this case, to the extent that a Participant or Access Person was not in a position to monitor the exemptions, potential trading opportunities may have been missed.

Simplifying Determination of Price Restrictions

Staff of RS considered several options to simplify compliance with the price restrictions on short sales including:

- providing that, in the absence of an information processor, the determination of the “last sale price” be made by reference to trades on the “principal market”; and
- replacing the “last sale” price test with a restriction that the order can not be entered at a price less than the “best ask” price at the time of order entry (and that any subsequent variation of the order can not reduce the price of the order to a price that is less than the best ask price at the time of the variation of the order).

Both of these options were considered in the context of complying with price restrictions on short sales in a multiple marketplace environment. Since each of the marketplaces currently system enforces compliance with the price restrictions by at least reference to the “principal market”, the use of the last sale price only from the principal market would have been the easiest to implement. However, there is no requirement that marketplaces system enforce short sale price restrictions. The second option considered by RS staff contemplated that if the price of the order at the time of entry or variation is in line with then prevailing market, there would be no obvious attempt on the part of a short seller to further reduce the market price. In the view of staff of RS, the elimination of tests based on the “last sale price” would assist Participants and Access Persons to manage affected orders and would facilitate marketplaces maintaining trading systems that can system enforce the price restrictions imposed by the rules.

The proposal to simplify the determination of price restrictions was tied to the proposals to provide additional exemptions from the price restrictions. Advice received by RS staff was that any benefits that might arise from the simplification of the determination of price restrictions did not offset the perceived burdens from administering an expanded exemption regime.

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

RS had indicated to both the Working Group and the Recognizing Regulators that, if the SEC proceeded with proposed amendments to Rule 10a-1 and Regulation SHO to remove short sale price restrictions on US markets, comparable relief may have to be granted to permit short sales on a marketplace without price restrictions if the security is inter-listed with an exchange in the United States. To have a markedly different standard for short sales on a marketplace as compared to trades in the same security on an organized regulated market in the United States would put marketplaces at a competitive disadvantage.

On June 13, 2007, the SEC approved amendments to remove the price restrictions on short sales as set out in Rule 10a-1 as well as any short sale price test of any self-regulatory organization.²⁸ In addition, the amendments prohibit any self-regulatory organization from having a price test. These amendments were effective July 3, 2007 with a compliance date indicated of July 6, 2007.

²⁸ For a description of the various amendments approved by the SEC on June 13, 2007, see “Approved Amendments to Regulation SHO and Short Position Reporting Requirements”.

Based on trading statistics of Canadian marketplaces for April of 2007, securities which are inter-listed with an exchange in the United States account for approximately 55% of the value of securities traded and approximately 30% of the volume of securities traded. In addition, approximately 25% of trades on a Canadian marketplace involve a short sale (including sales which qualify as “short exempt” from the price restrictions under Rule 3.1 of UMIR). These numbers indicate the significant extent to which trading on Canadian marketplaces may be impacted by the decision of the SEC to repeal price restrictions on short sales.

In light of the decision of the SEC to remove price restrictions on short sales, RS 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.²⁹ 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 exchange³⁰ in the United States do not qualify for the exemption.

If a particular marketplace does not support the “short exempt” marker, the order must be marked as “short”. In this circumstance, if the marketplace has system enforced compliance with the price restrictions on short sales, the marketplace may suspend the automatic enforcement of the price restrictions on securities covered by the exemption. If a marketplace is unable to suspend the automatic enforcement of the price restrictions on securities covered by the exemption, short sales of exempt securities on that marketplace will be executed at a price not less than the last sale price of the security.

As the exemption from the price restrictions on a short sale in respect of securities which are inter-listed on an exchange in the United States is an exemption to a class of transactions, the concurrence of the Recognizing Regulators was obtained in accordance with Rule 11.1. The exemption will expire upon the Proposed Amendments becoming effective following approval by the Recognizing Regulators or upon the withdrawal of the Proposed Amendments from consideration by the Recognizing Regulators.

Additional Restrictions on Short Sales

Definition of “Short Sale Ineligible Security”

The Proposed Amendments would allow the Market Regulator to designate a particular security or a class of securities as being ineligible to be sold “short”. This purpose of this provision would be to provide additional flexibility to the Market Regulator to respond to developments in trading of a particular security or class of securities if rates of failed trades become, in the opinion of the Market Regulator, excessive.³¹

Effective April 1, 2005, the provisions of Policy 2.2 regarding False or Misleading Appearance of Trading Activity or Artificial Price were amended to specifically provide 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”³² 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. The CSA Trading Rules contain comparable prohibitions for trading which is not subject to UMIR.³³

On October 1, 2007, National Instrument 24-101 – *Institutional Trade Matching and Settlement* will become effective. That instrument requires registered dealers to establish, maintain and enforce policies and procedures designed to facilitate settlement of trades by the standard settlement date. In determining whether a Participant had a “reasonable expectation of settling” a trade for the purposes of Policy 2.2, RS would consider whether the Participant was in compliance with the policies and procedures adopted in accordance with the requirements of National Instrument 24-101.

In the view of RS, the amendments to Policy 2.2 that were effective on April 1, 2005 should preclude short selling in so-called “death spiral” situations. Historically, a “death spiral” had occurred when an issuer was undergoing certain types of

²⁹ 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).

³⁰ An exchange is a market that is registered as an “exchange” under the *Exchange Act of 1933* (United States). In particular, it should be noted that an ECN, the Bulletin Board and the Pink Sheets are NOT an “exchange”.

³¹ 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. With the proposed expansion of the exemptions from price restrictions related to short selling, the ability of the Market Regulator to curtail short selling in a particular security that is evidencing persistent settlement failures may become necessary.

³² Clause (h) of Part 2 of Policy 2.2

³³ See clause 3.1(3)(g) of Companion Policy 23-101CP.

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.

If, based on reports of failed trades submitted to RS in accordance with the Rule 7.11 under the Proposed Amendments or other sources of information, RS became aware of systemic failures to settle trades in a particular security or class of securities that were related to short selling activity, the Proposed Amendment would permit RS to designate the particular security or class of securities as being ineligible for a short sale. A designation to preclude a particular security or class of securities from being able to be sold "short" would only be made by RS with the concurrence of the Recognizing Regulators.

The results of the "Statistical Study of Failed Trades on Canadian Marketplaces" indicated that the majority of trade failures were the result of administrative delay or error. For this reason, RS is not in favour of the approach used in the United States. (Reference should be made to "Statistical Study of Failed Trades on Canadian Marketplaces".)

Exercise of Options, Rights and Warrants

Under the definition of "short sale" in Rule 1.1 of UMIR, a seller shall be considered to own a security under various circumstances including if the seller:

- owns directly or through an agent or trustee another security that is convertible or exchangeable into that security and has tendered such other security for conversion or exchange or has issued irrevocable instructions to convert or exchange such other security;
- has an option to purchase the security and has exercised the option; or
- has a right or warrant to subscribe for the security and has exercised the right or warrant.

The Proposed Amendments would clarify the circumstances when a seller would be taken to have "converted", "exchanged" or "exercised" securities for the purposes of the definition. Under the Proposed Amendments, the seller must have taken all steps necessary to become legally entitled to the security, including having:

- made any payment required;
- submitted to the appropriate person any required forms or notices; and
- submitted, if applicable, to the appropriate person any certificates for securities to be converted, exchanged or exercised.

If the seller has not taken all necessary steps to become legally entitled to the security, the seller will be considered to be making a short sale.

Variation and Cancellation of Trades After Execution

The Proposed Amendments would introduce a requirement that a trade could not be cancelled or varied (with respect to: the price of the trade; the volume of the trade; or the date for settlement of the trade) except if the cancellation or variation was made by:

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

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 through 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 disseminated to the appropriate information vendors.

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 for a Participant or Access Person is to contact CDS to add, vary or cancel trades prior to settlement. CDS reports these variations or cancellations to the marketplace for review and, in turn, the marketplace forwards the report to RS. If RS 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 shall be provided to RS by each Participant and Access Person that is a party to the trade.

The purpose of the amendment is to ensure that a trade variation or cancellation is not effected outside the normal processes of the marketplaces and CDS unless RS 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 RS or another regulation services provider 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).

Handling of Failed Trades

Report of a "Failed Trade"

Securities regulators generally have a concern regarding the relationship between failed trades and preserving market integrity. Currently under UMIR, a Participant or Access Person does not have to report to a regulation services provider or other regulatory body the existence of a "failed trade". In order to ensure that the audit trail for any trade is accurate and that RS has sufficient information to evaluate whether trading activity has been conducted in compliance with UMIR and other regulatory requirements, the Proposed Amendments would introduce a requirement that each Participant or Access Person would be required to report to RS or another regulation services provider if a trade that has failed to settle on the settlement date remains unresolved 10 trading days following the settlement date. These reports would also allow RS or another regulation services provider 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 a "failed trade" had been filed with RS, the Participant or Access Person would be required to file a second report once the account had cured the default. In this way, RS will be in a position to monitor trends in "failed trades" including the steps which a Participant or Access Person may be taking to rectify the default. Information from the reports would be used by RS in making a determination whether a particular security should be designated as a "Short Sale Ineligible Security". (See "Definition of "Short Sale Ineligible Security".)

RS expects that both the initial report of a failed trade and the report of the closing out of the position would be filed electronically with RS in a standard form that would permit RS to assemble the information in a database for analysis purposes. The Proposed Amendments provide that such reports are to be filed at such time as may be required by RS. At this time, RS would expect that the initial report would be provided to RS on the eleventh trading day following the "failure" and that the "close-out" report would be provided to RS by the trading day following the cure of the default. (See "Technological Implications and Implementation Plan".)

As indicated in the results of the "Statistical Study of Failed Trades on Canadian Marketplaces", failed trades accounted for only 0.27% of the total number of trades executed. In addition, the study found that the predominant cause of failed trades is administrative delay or error and that approximately 96% of failed trades are settled within 10 trading days after the "expected" settlement date. With the introduction of a reporting obligation after 10 trading days as suggested by the Proposed Amendments, RS would expect that Participants and Access Persons may modify their policies and procedures in an attempt to maximize the settlement rate prior to becoming subject to the reporting obligation.³⁴ Based on the results of the study, RS would anticipate that a report would be required in connection with approximately 0.01% of trades.

RS considered the introduction of "fails list" patterned on the requirements under Regulation SHO in the United States. However, given the generally lower rates of trade failure in Canada and the absence of a direct link between short selling and trade failure, RS proposed a more direct obligation to report specific failed trades.³⁵ RS acknowledges that the requirement to report "failed trades" would impose an additional administrative burden on Participants and Access Persons. However, this additional burden will be imposed in respect of a statistically insignificant number of trades and may be off-set by the elimination

³⁴ The Study indicated that the "buy-in" procedures of CDS or the marketplaces were invoked in only 4% of the failed trades involving Study Participants. See "Statistical Study of Failed Trades on Canadian Marketplaces". Use of the existing buy-in procedures to close-out fail positions may become more prevalent in order to avoid triggering the reporting requirements related to failed trades that would be introduced by the Proposed Amendments.

³⁵ See "CSA/SRO Working Group on Short Selling and Failed Trades Issues" and "Statistical Study of Failed Trades on Canadian Marketplaces".

of the requirement to prepare and file the Consolidated Short Position Report (“CSPR”) twice a month.³⁶ In addition, it should be noted that the imposition of the administrative burden is on the Participant involved in the particular failed trade. In the view of RS, the imposition of the burden on a particular Participant is preferable to the approach in the United States with the addition of a security to the “fails list” resulting in administrative and compliance burdens on all dealers whether or not they have been involved in failed trades of the particular security.

Definition of a “Failed Trade”

The Proposed Amendments would define a “failed trade” as a trade resulting from the execution of an order entered by a Participant or Access Person on a marketplace on behalf of an account and

- in the case of a sale, other than a short sale, the account failed to make available securities in such number and form;
- in the case of a short sale, the account failed to make:
 - available securities in such number and form, or
 - arrangements with the Participant or Access Person to borrow securities in such number and form; and
- in the case of a purchase, the account failed to make available monies in such amount,

as to permit the settlement of the trade at the time on the date contemplated on the execution of the trade. The definition also confirms that a trade shall be considered a “failed trade” irrespective of whether the trade has been settled in accordance with the rules or requirements of the clearing agency. The definition measures the existence of a “failed trade” at the account level and the default of the account holder in meeting settlement obligations. For example, if a Participant “fails” to settle both the purchase and sale of given amount of a particular security, the position of the Participant at the clearing agency may be “accurate” as a result of continuous net settlement but there remain two accounts which have defaulted on their settlement obligations. If this default persisted for a period of ten trading days beyond the normal settlement date, each of the accounts would be considered to have a “failed trade”.

Provision for Cancellation of a “Failed Trade”

From a policy perspective, one of the objectives of market integrity rules is to ensure that all trades executed on a marketplace are “bona fide” and that all such trades settle in the ordinary course. If an account has defaulted in its settlement obligations, this failure may be indicative of improper behaviour if the default is not cured within a reasonable period of time.

In order to further encourage the timely performance of obligations, the Proposed Amendments would amend Rule 10.9 to specifically authorize a Market Integrity Official to cancel any trade that is a failed trade in respect of which notice has been, or should have been, provided to the Market Regulator in accordance with Rule 7.11 if, in the opinion of such Market Integrity Official:

- the account has failed to diligently pursue making available the applicable securities or monies or making arrangement for the borrowing of the applicable securities;
- there is no reasonable prospect that the failure will be rectified pursuant to the rules, requirements or procedures of the marketplace on which the trade was executed or the clearing agency through which the trade was to be settled; and
- the cancellation of the trade is appropriate in the interest of a fair and orderly market.

In particular, this provision is aimed at the less than 2% of failed trades that are not resolved within 15 days after the expected “settlement” date. In these circumstances, RS must be satisfied that there is a valid reason for the continuing default and not merely an attempt to “game” future price levels in the affected security. The proposed provision is not intended to provide a mechanism for an account to be absolved of a “bad trade” but to ensure timely performance. For example, if an account has made a short sale and failed to deliver the securities on ordinary settlement, it would not be acceptable to further delay the delivery of securities in the hope that the market price of a security might decline further permitting the short position to be covered at an even lower price.

³⁶ See “Short Position Reports”.

Anti-Avoidance Provisions

The trigger for the reporting obligation with respect to a failed trade is for the account to have been in default for a period of 10 trading days after the original settlement date of the trade. The Proposed Amendments would make a consequential amendment to Policy 2.1 to confirm that entering into a transaction or series of transactions in an attempt to "re-age" the default such that a report of the original failed trade would not have to be filed would be considered a violation of the requirement to conduct trading openly and fairly.

Short Position Reports

Historically, the TSX produced a "Consolidated Short Position Report" on behalf of the various stock exchanges in Canada. When UMIR was adopted in 2002, Rule 10.10 required Participants and Access Persons to prepare and file a short position report twice-monthly with respect to short positions in securities traded on a marketplace. The TSX continued to produce the CSPR as a service for RS and also continued to sell the CSPR as a data product, as well as providing it to listed issuers at no cost.

It is RS's view that the preparation of these reports imposes an administrative burden on Participants, Access Persons and the TSX. RS would note that the CSPR is not used extensively by RS for any regulatory purpose as the information it contains is of limited regulatory utility. Currently, the report is costly for TSX to produce due to the extensive manual effort required and, as such, the TSX may have to increase the cost of the report in order to recover its expenses associated with its production and distribution. In addition, there are significant compliance costs for the Participants and Access Persons, which must prepare and submit the short position reports on a semi-monthly basis.

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 Exchange, 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).

As well, currently, the CSPR does not include the short position in securities which are listed on CNQ. With the imminent introduction of additional marketplaces to Canada, RS would like to ensure that, if the decision is made to retain the current or an expanded CSPR, such report is truly "consolidated" and reflects the short position in securities traded on all marketplaces in Canada.

RS has considered whether the CSPR in its present form provides sufficient meaningful information to the market, given the costs and efforts associated with its production. It is the view of RS that there are alternative mechanisms to provide information in a timely or cost effective manner (e.g. to what extent would periodic summaries produced by marketplaces of "short sales" undertaken on those marketplaces based on the "short" marker meet the needs of the users of the CSPR while easing the administrative burden on both the TSX and the Participants).

As an alternative, the CSPR could be retained and made more meaningful by categorizing the short position as "covered", "hedged", "naked" or "closing out of a short sale" to more accurately reflect the possible future buying interest that may be required to offset the short position in any account. However, if the CSPR were to become more detailed, Participants and Access Persons may also have to mark their orders in a more detailed way than simply the "short" or "short-exempt" markers currently required. It has also been suggested that the "covered", "hedged", "naked" or "closing out of a short sale" markings be displayed publicly in real-time trade execution dissemination, rather than summarized in a delayed report. It is the view of RS that the benefits of incorporating all or any of the above additional information into the CSPR, while making the report more meaningful, would be outweighed by the higher compliance cost for Participants and Access Persons and, in the case of additional order marking, may be impractical and could hamper order handling. As such, RS does not support the further expansion of the CSPR.

The Proposed Amendments would repeal the requirement for preparing and filing a short position report under Rule 10.10 of UMIR. The repeal would relieve Participants, Access Persons and TSX of the administrative burdens in respect of the production and dissemination of the CSPR. The repeal of Rule 10.10 of UMIR would only become effective, if the Board is satisfied that adequate information on short sales executed on a marketplace had become generally available. To replace the CSPR, RS envisages the dissemination by third parties of periodic summary reports of short sales effected on marketplaces in

particular securities. In the view of RS staff, the summary report of short sales should be produced no less frequently than semi-monthly, the time period covered by the current CSPR. In addition, RS staff is of the view that the release of the summary report should be delayed for three trading days to give Participants and Access Persons time to correct the markers on any order on a post-trade basis. (See "Repeal of Requirement for Short Position Reports" under the heading "Technological Implications and Implementation Plan".)

RS recognizes that, on March 6, 2007, the SEC approved proposed rule amendments submitted by the NASD, NYSE and AMEX, which among other things, increase the frequency of the short interest reporting requirements from monthly to twice per month. The amendments do not otherwise vary the short position reporting requirements, including the type of information to be included in such reports. It should also be noted that short sale reporting obligations in the United Kingdom, Australia and Hong Kong range from daily reporting to no reporting other than marking trades as "short". Nonetheless, RS believes that the dissemination of trading summaries of "short" sales provides an opportunity to:

- relieve Participants and marketplaces of an on-going administrative burden; and
- provide market participants with more timely and accurate information on short selling activity in particular securities.

RS recognizes that in order to ensure that the summary data on short sale trading activity is accurate, each Participant and Access Person would have to ensure that their policies and procedures for order marking are adequate and that short sales are properly marked even when the order would not be subject to price restrictions. For the summary data to provide meaningful and accurate information, the practice of bundling "long" and "short" sales together in certain circumstances would have to be terminated and Participants and Access Persons may require new processes for identifying and correcting improperly marked short sales.

Order Markers

If the Proposed Amendment to repeal price restrictions on a short sale is approved, a consequential change must be made to the order marking requirements under Rule 6.2 to eliminate the requirement for a special marker on short sale orders which are exempt from short sale price restrictions. The Proposed Amendments would retain a requirement that a short sale be marked.

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:

- removes the restrictions on the price at which a short sale may be executed;
- eliminates the requirement to file "Short Position Reports" (provided adequate information on short sales executed on a marketplace becomes available);
- limits the ability to vary (with respect to price, volume or settlement date) or cancel a trade after execution unless notice has been provided to a Market Regulator;
- requires a report of a "failed trade" be made if the reason for the failure is not resolved within ten trading days following the original settlement date of the trade;
- provides a Market Integrity Official with specific power to cancel a "failed trade" under certain circumstances; and
- replaces the CSPR with summary data on short sale activity on marketplaces thereby increasing the importance of correct order marking (even in circumstances when an order would be exempt from the price restrictions on short sales).

Technological Implications and Implementation Plan

Repeal of Price Restrictions on Short Sales

Currently, each of the marketplaces enforces compliance with the price restrictions on short sales by reference to the "last sale price" on the principal market. Each of the marketplaces may have to undertake changes to its trading systems to permit the execution of a short sale at prices below the last sale price. Similarly, to the extent that a marketplace may decide to system enforce restrictions on short sales, adjustments would have to be made to accommodate the introduction of the concept of a "Short Sale Ineligible Security" that would preclude a short sale of a designated security.

In order to provide Participants, Access Persons, marketplaces and service providers with an opportunity to make changes to their programming to accommodate the introduction of these changes, implementation of the various provisions related to price restrictions on short sales would be deferred for a period of not less than 30 days following the date of approval of the Proposed Amendments by the Recognizing Regulators on a date to be determined by the Board. It would be the intention of RS to issue a Market Integrity Notice announcing the date these provisions would be implemented at least 10 days in advance of the implementation date determined by the Board.

If price restrictions on short sales are repealed and a marketplace has not been able to revise its trading system by the date the repeal becomes effective, RS would permit short sales to be entered on a marketplace as "short exempt" until such time as the trading system of the marketplace had been revised to stop the enforcement of price restrictions on short sales.

Provision for a "Short Sale Ineligible Security"

The Proposed Amendments would preclude a short sale of any security that had been designated by a Market Regulator as being ineligible to be sold short. To the extent that a marketplace may decide to system enforce restrictions on short sales, adjustments to the trading system of the marketplace would have to be made to accommodate the introduction of the concept of a "Short Sale Ineligible Security".

In order to provide Participants, Access Persons, marketplaces and service providers with an opportunity to make changes to their programming to accommodate the introduction of this change, implementation of the restriction on short sales of a security designated as a "Short Sale Ineligible Security" would be deferred for a period of not less than 90 days following the date of approval of the Proposed Amendments by the Recognizing Regulators on a date to be determined by the Board. It would be the intention of RS to issue a Market Integrity Notice announcing the date these provisions would be implemented at least 30 days in advance of the implementation date determined by the Board.

Repeal of Requirement for Short Position Reports

The repeal of Rule 10.10 under the Proposed Amendments would become effective upon a date determined by the Board. It is anticipated that the production and dissemination of the CSPR would continue for a period of six months to a year following the introduction of the summary reports on short sales executed on marketplaces in order to allow the current users of the CSPR an opportunity to evaluate the information provided by trading summaries. The production of both trading summaries and the CSPR would provide RS an opportunity to track the relationship between information provided in the CSPR with the marketplace trading summaries. If the study undertaken by RS concluded that the trading summaries were an appropriate replacement for the CSPR, the Board would establish an effective date for the repeal of Rule 10.10. (See "Impact Study".)

If the Proposed Amendments are approved, RS would pursue the introduction of the trade summaries on the most cost effective and efficient basis (after consultation with the applicable securities regulatory authorities and marketplaces). At this time, RS believes that the options for the preparation of a consolidated summary report would be by:

- marketplaces acting co-operatively (in a manner similar to the preparation of the CSPR today);
- RS using the regulatory feed provided for trades on all regulated marketplaces; or
- the information processor, if one is approved for all regulated marketplaces.

Reports of "Failed Trades" and Trade Variations and Cancellation

If the Proposed Amendments related to a Participant or Access Person providing notice to RS of a "failed trade" or of a variation or cancellation of a trade subsequent to its execution are approved, RS will have to implement a secure electronic method for a Participant or Access Person to provide such notice or report to RS. (Prior to the settlement of the trade, any notice of variation or cancellation would be provided to RS by the marketplace or clearing agency). RS will also have to develop databases to store the information provided and monitoring tools to assist in the analysis of the information received.

In order to provide Participants and Access Persons with an opportunity to make changes to their policies and procedures to accommodate the introduction of these notice and reporting obligations, implementation of the various provisions related to the provision of notice to RS respecting such trades would be deferred for a period of not less than 90 days following the date of approval of the Proposed Amendments by the Recognizing Regulators on a date to be determined by the Board. It would be the intention of RS to issue a Market Integrity Notice announcing the date these provisions would be implemented at least 30 days in advance of the implementation date determined by the Board.

Impact Study

If the Proposed Amendments are approved, RS intends to undertake an empirical study of the impact of the amendments ("Impact Study"). While the construction and methodology of the Impact Study will depend on the content and effective date of the approved amendments, the Impact Study would be conducted following the implementation of the Proposed Amendments. RS anticipates that the Impact Study would:

- analyze trading and settlement activity of listed securities (including both liquid and illiquid securities listed on TSX, TSXV and CNQ);
- last for a period of up to one year prior to and up to one year following the effective date of the approved amendments; and
- be based on five or more categories of listed securities being:
 - securities inter-listed with an exchange in the United States,
 - securities which qualify as "highly-liquid", and
 - at least three tiers of "illiquid" securities determined by relative liquidity.

The Impact Study would attempt to determine whether the approved amendments had an effect on:

- volume of short selling;
- rates of trade failure;
- the relationship, or the lack thereof, between levels of short selling and trade failure;
- the ability to detect manipulative or deceptive trading in circumstances when abusive short selling has occurred;
- price volatility and the operation of the price discovery mechanism; and
- levels of displayed liquidity.

The Impact Study would also attempt to determine whether there was a difference in the effects based on the presence of "market stress" for the particular security or securities generally. In this context, "stress" would be measured by unusual volumes or price movement.

While the SHO Pilot Project had found no evidence that the results of the Pilot Project would not be applicable to smaller or less liquid securities, the Impact Study would attempt to confirm whether this finding was applicable in the Canadian context. If the Impact Study found that the effect of the approved amendments varied significantly due to the liquidity of the issuers or if the Impact Study found deterioration in the rate of trade settlement, RS would then consider whether other additional amendments should be made to UMIR to incorporate comparable provisions from Regulation SHO (such as locate requirements, fail lists and close-out requirements.) Depending upon the findings of the Impact Study, RS may also consider whether price restrictions on short sales should be re-introduced for certain types of illiquid securities.

The Impact Study would also provide an opportunity to track the relationship between information provided in the CSPR with that provided in the periodic trading summaries of short selling activity on marketplaces. If the Impact Study concluded that the trading summaries were an appropriate replacement for the CSPR, the Board would establish an effective date for the repeal of Rule 10.10.

Staff of RS considered a proposal for a "pilot project" (which would have provided an exemption from the price restrictions on a short sale for a range of securities including both highly-liquid and "illiquid" securities prior to repealing the price restrictions for all securities) as an alternative to the Impact Study. The TSXV currently does not support the "short exempt" marker. While the TSXV has indicated an intention to introduce the "short exempt" marker, the TSXV has not publicly announced a timetable for its introduction. The introduction of a pilot project would either have to be delayed until the TSXV had implemented the "short exempt" marker or would have necessitated significant programming changes by TSXV and possibly Participants accessing that marketplace in order to enable the price restrictions to be suspended for a subset of TSXV securities. As such, in the opinion of RS staff, a pilot project could not be implemented in a cost efficient and timely manner (as compared to the repeal of price restrictions on short sales of all securities accompanied by an impact study).

Specific Matters on Which Comment is Requested

Comment is requested on all aspects of the Proposed Amendments, including comments on policy alternatives that may be available to the implementation of the Proposed Amendments. However, comment is specifically requested on the following matters:

Repeal of Price Restrictions on Short Sales

The Proposed Amendments contemplate the repeal of all price restrictions on the execution of a short sale. Based on the results of the Pilot Project in the US which commenced on May 2, 2005, the OEA indicated that there was evidence of increased volatility in connection with less liquid securities. Implementation of the Proposed Amendments would be accompanied by the Impact Study to evaluate the effect of the repeal of price restrictions on the short sale of illiquid securities. Depending upon the findings of the Impact Study, RS may consider whether price restrictions on short sales should be re-introduced for certain types of illiquid securities. RS believes that its existing system alerts and procedures will allow RS to monitor abusive shorting for manipulative effects during the period of the Impact Study. An alternative approach would involve a "pilot project" under which a number of illiquid securities would be exempt from price restrictions on short sales while retaining the restrictions on a control group of illiquid securities.

1. *Should RS consider a "pilot project" to evaluate the effect of the repeal of price restrictions on the short sale of illiquid securities rather than the outright repeal of all price restrictions?*
2. *If RS were to undertake a pilot project, what should be the duration of the pilot project?*
3. *How should a pilot project be implemented for TSXV-listed securities if the TSXV does not support the "short exempt" marker?*
4. *What costs or administrative burdens would marketplaces, Participants and Access Persons incur in connection with a pilot project?*

Harmonization with Requirements in the United States

The SEC has adopted, or proposed to adopt, a number of provisions regarding short sales and failed trades including:

- mandatory locate requirements prior to the execution of a short sale;
- maintenance of a "fails list";
- "close-out" requirements for securities on the fails list; and
- "documentation" requirements for sales indicated as from a "long" position.

RS has not proposed similar measures based on the results of empirical studies in Canada indicating that the rates of trade failure are significantly lower than in the US and there is no connection between short sales and trade failure in Canada (i.e., a short sale does not involve a higher risk of trade failure).

5. *Would there be any specific costs or benefits associated with UMIR adopting provisions comparable to those in the United States related to short sales (such as a mandatory locate requirement, and documentation requirements for sales from a long position) and/or failed trades (such as the maintenance of a fails list and close-out requirements for securities on the fails list)?*

Appendices

- Appendix "A" sets out the text of the Proposed Amendments to the Rules and Policies respecting short sales and failed trades; and
- Appendix "B" contains the text of the relevant provisions of the Rules and Policies as they would read on the adoption of the Proposed Amendments. Appendix "B" also contains a marked version of the current provisions highlighting the changes introduced by the Proposed Amendments.

Questions / Further Information

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Appendix "A"

Provisions Respecting Short Sales and Failed Trades

The Universal Market Integrity Rules are hereby amended as follows:

1. Rule 1.1 is amended by:

(a) adding the following definition of "failed trade":

"failed trade" means a trade resulting from the execution of an order entered by a Participant or Access Person on a marketplace on behalf of an account and

(a) in the case of a sale, other than a short sale, the account failed to make available securities in such number and form;

(b) in the case of a short sale, the account failed to make:

(i) available securities in such number and form, or

(ii) arrangements with the Participant or Access Person to borrow securities in such number and form; and

(c) in the case of a purchase, the account failed to make available monies in such amount,

as to permit the settlement of the trade at the time on the date contemplated on the execution of the trade provided a trade shall be considered a "failed trade" irrespective of whether the trade has been settled in accordance with the rules or requirements of the clearing agency.

(b) inserting at the beginning of clause (b) in the definition of "short sale" the phrase "owns directly or through an agent or trustee another security that is convertible or exchangeable into that security and"; and

(c) adding the following definition of "Short Sale Ineligible Security":

"Short Sale Ineligible Security" means a security or a class of securities 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 for a particular trading day or trading days.

2. Rule 3.1 is deleted and the following substituted:

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:

(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.

3. Amending clause (b) of subsection (1) of Rule 6.2 by:

(a) deleting in subclause (viii) the phrase "which is subject to the price restriction under subsection (1) of Rule 3.1"; and

(b) deleting subclause (ix).

4. Adding the following as Rule 7.11

7.11 Failed Trades

(1) If within ten trading days following the date for settlement contemplated on the execution of a failed trade, the account:

(a) in the case of a sale, other than a short sale, that failed to make available securities in such number and form;

- (b) in the case of a short sale, that failed to make:
 - (i) available securities in such number and form, or
 - (ii) arrangements with the Participant or Access Person to borrow securities in such number and form; and

- (c) in the case of a purchase, that failed to make available monies in such amount,

as to permit the settlement of the trade at the time on the date contemplated on the execution of the trade has not made available such securities or monies or has not made arrangements for the borrowing of the securities, as the case may be, the Participant or Access Person that entered the order on a marketplace shall give notice to the Market Regulator at such time and in such form and manner and containing such information as may be required by the Market Regulator.

- (2) If a Participant or Access Person is required to provide notice of a failed trade to the Market Regulator in accordance with subsection (1), the Participant or Access Person shall, upon the account making available the applicable securities or monies or making arrangement for the borrowing of the applicable securities, give notice to the Market Regulator at such time and in such form and manner and containing such information as may be required by the Market Regulator.

- 5. Adding the following as Rule 7.12

7.12 Variation and Cancellation of Trades

No trade executed on a marketplace shall, subsequent to the execution of the trade, be:

- (a) cancelled; or
- (b) varied with respect to:
 - (i) the price of the trade,
 - (ii) the volume of the trade, or
 - (iii) the date for settlement of the trade,

except:

- (c) by the Market Regulator in accordance with the Rules; or
- (d) with notice to the Market Regulator immediately following the variation or cancellation of the trade in such form and manner as may be required by the Market Regulator and such notice shall be given, if the variation or cancellation is made:
 - (i) prior to the settlement of the trade, by:
 - (A) the marketplace on which the trade was executed, or
 - (B) the clearing agency through which the trade is or was to be cleared and settled, and
 - (ii) after the settlement of the trade, by each Participant and Access Person that is a party to the trade.

- 6. Rule 10.9 is amended by adding the following as clause (e.1):

- (e.1) cancel any trade that is a failed trade in respect of which notice has been, or should have been, provided to the Market Regulator in accordance with Rule 7.11 if, in the opinion of such Market Integrity Official:
 - (i) the account has failed to diligently pursue making available the applicable securities or monies or making arrangement for the borrowing of the applicable securities,

- (ii) there is no reasonable prospect that the failure will be rectified pursuant to the rules, requirements or procedures of the marketplace on which the trade was executed or the clearing agency through which the trade was to be settled, and
- (iii) the cancellation of the trade is appropriate in the interest of a fair and orderly market.

7. Rule 10.10 is repealed.

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

1. Policy 1.1 is amended by adding the following as Part 3:

Part 3 – Definition of “Short Sale”

Under the definition of “short sale”, a seller shall be considered to own a security under various circumstances including if the seller:

- owns directly or through an agent or trustee another security that is convertible or exchangeable into that security and has tendered such other security for conversion or exchange or has issued irrevocable instructions to convert or exchange such other security;
- has an option to purchase the security and has exercised the option; or
- has a right or warrant to subscribe for the security and has exercised the right or warrant.

In each of these circumstances, the seller must have taken all steps necessary to become legally entitled to the security, including having:

- made any payment required;
- submitted to the appropriate person any required forms or notices; and
- submitted, if applicable, to the appropriate person any certificates for securities to be converted, exchanged or exercised.

2. Part 1 of Policy 2.1 is amended by deleting the second paragraph and substituting the following:

Participants and Access Persons who intentionally organize their business and affairs with the intent or for the purpose of avoiding the application of a Requirement may be considered to have engaged in behaviour that is a failure to conduct business openly and fairly or in accordance with just and equitable principles of trade. For example, the Market Regulator considers that a person who is under an obligation to enter orders on a marketplace who “uses” another person to make a trade off of a marketplace (in circumstances where an “off-market exemption” is not available) to be violating the requirement to conduct business openly and fairly or in accordance with just and equitable principles of trade. Similarly, the Market Regulator considers that a person who enters into a transaction for the purpose of rectifying a failure in connection with a failed trade prior to the time that a report must be filed in accordance with Rule 7.11 and such person knows or ought reasonably to know that such transaction will result in a failed trade to be engaging in “re-aging” for the purpose of avoiding reporting obligations contrary to the requirement to conduct business openly and fairly or in accordance with just and equitable principles of trade.

3. Policy 3.1 is deleted.

Appendix “B”

Text of Rules and Policies to Reflect Proposed Amendments Respecting Short Sales and Failed Trades

| Text of Provisions of Following Adoption of Proposed Amendments | Text of Current Provisions Marked to Reflect Adoption of Proposed Amendments |
|--|---|
| <p>1.1 Definitions</p> <p>“failed trade” means a trade resulting from the execution of an order entered by a Participant or Access Person on a marketplace on behalf of an account and</p> <p>(a) in the case of a sale, other than a short sale, the account failed to make available securities in such number and form;</p> <p>(b) in the case of a short sale, the account failed to make:</p> <p>(i) available securities in such number and form, or</p> <p>(ii) arrangements with the Participant or Access Person to borrow securities in such number and form; and</p> <p>(c) in the case of a purchase, the account failed to make available monies in such amount,</p> <p>as to permit the settlement of the trade at the time on the date contemplated on the execution of the trade provided a trade shall be considered a “failed trade” irrespective of whether the trade has been settled in accordance with the rules or requirements of the clearing agency.</p> | <p>1.1 Definitions</p> <p>“failed trade” means <u>a trade resulting from the execution of an order entered by a Participant or Access Person on a marketplace on behalf of an account and</u></p> <p><u>(a) in the case of a sale, other than a short sale, the account failed to make available securities in such number and form;</u></p> <p><u>(b) in the case of a short sale, the account failed to make:</u></p> <p><u>(i) available securities in such number and form, or</u></p> <p><u>(ii) arrangements with the Participant or Access Person to borrow securities in such number and form; and</u></p> <p><u>(c) in the case of a purchase, the account failed to make available monies in such amount,</u></p> <p><u>as to permit the settlement of the trade at the time on the date contemplated on the execution of the trade provided a trade shall be considered a “failed trade” irrespective of whether the trade has been settled in accordance with the rules or requirements of the clearing agency.</u></p> |
| <p>“short sale” means a sale of a security, other than a derivative instrument, which the seller does not own either directly or through an agent or trustee and, for this purpose, a seller shall be considered to own a security if the seller:</p> <p>(a) has purchased or has entered into an unconditional contract to purchase the security, but has not yet received delivery of the security;</p> <p>(b) owns directly or through an agent or trustee another security that is convertible or exchangeable into that security and has tendered such other security for conversion or exchange or has issued irrevocable instructions to convert or exchange such other security;</p> <p>(c) has an option to purchase the security and has exercised the option;</p> <p>(d) has a right or warrant to subscribe for the security and has exercised the right or warrant; or</p> <p>(e) is making a sale of a security that trades on a when issued basis and the seller has entered into a contract to purchase such security which is binding on both parties and subject only to the condition of issuance of distribution of the security,</p> <p>but a seller shall be considered not to own a security if:</p> | <p>“short sale” means a sale of a security, other than a derivative instrument, which the seller does not own either directly or through an agent or trustee and, for this purpose, a seller shall be considered to own a security if the seller:</p> <p>(a) has purchased or has entered into an unconditional contract to purchase the security, but has not yet received delivery of the security;</p> <p><u>(b) owns directly or through an agent or trustee another security that is convertible or exchangeable into that security and has tendered such other security for conversion or exchange or has issued irrevocable instructions to convert or exchange such other security;</u></p> <p>(c) has an option to purchase the security and has exercised the option;</p> <p>(d) has a right or warrant to subscribe for the security and has exercised the right or warrant; or</p> <p>(e) is making a sale of a security that trades on a when issued basis and the seller has entered into a contract to purchase such security which is binding on both parties and subject only to the condition of issuance of distribution of the security,</p> <p>but a seller shall be considered not to own a security if:</p> |

| Text of Provisions of Following Adoption of Proposed Amendments | Text of Current Provisions Marked to Reflect Adoption of Proposed Amendments |
|---|---|
| <p>(f) the seller has borrowed the security to be delivered on the settlement of the trade and the seller is not otherwise considered to own the security in accordance with this definition;</p> <p>(g) the security held by the seller is subject to any restriction on sale imposed by applicable securities legislation or by an Exchange or QTRS as a condition of the listing or quoting of the security; or</p> <p>(h) the settlement date or issuance date pursuant to:</p> <ul style="list-style-type: none"> (i) an unconditional contract to purchase, (ii) a tender of a security for conversion or exchange, (iii) an exercise of an option, or (iv) an exercise of a right or warrant <p>would, in the ordinary course, be after the date for settlement of the sale.</p> | <p>(f) the seller has borrowed the security to be delivered on the settlement of the trade and the seller is not otherwise considered to own the security in accordance with this definition;</p> <p>(g) the security held by the seller is subject to any restriction on sale imposed by applicable securities legislation or by an Exchange or QTRS as a condition of the listing or quoting of the security; or</p> <p>(h) the settlement date or issuance date pursuant to:</p> <ul style="list-style-type: none"> (i) an unconditional contract to purchase, (ii) a tender of a security for conversion or exchange, (iii) an exercise of an option, or (iv) an exercise of a right or warrant <p>would, in the ordinary course, be after the date for settlement of the sale.</p> |
| <p>“Short Sale Ineligible Security” means a security or class of securities 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 for a particular trading day or trading days.</p> | <p>“Short Sale Ineligible Security” means a security or a class of securities that has been designated by a Market Regulator to be a security in respect of which an order that <u>on execution would be a short sale may not be entered on a marketplace for a particular trading day or trading days.</u></p> |
| <p>3.1 Restrictions on Short Selling</p> <p>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:</p> <ul style="list-style-type: none"> (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. | <p>3.1 Restrictions on Short Selling</p> <p>(1) Except as otherwise provided, a Participant or Access Person shall not <u>enter an order to sell</u> make a short sale of a security on a marketplace that on execution would be a short sale; unless the price is at or above the last sale price.</p> <p><u>(a) unless the order is marked as a short sale in accordance with subclause 6.2(1)(b)(viii); or</u></p> <p><u>(b) if the security is a Short Sale Ineligible Security at the time of the entry of the order.</u></p> |
| | <p>(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:</p> <ul style="list-style-type: none"> (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; (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 |

| Text of Provisions of Following Adoption of Proposed Amendments | Text of Current Provisions Marked to Reflect Adoption of Proposed Amendments |
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| | <p>available and the seller intends to accept such offer immediately;</p> <p>(d) for the account of a derivatives market maker and is made:</p> <p>(i) in accordance with the market making obligations of the seller in connection with the security or a related security, and</p> <p>(ii) to hedge a pre-existing position in the security or a related security;</p> <p>(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; or</p> <p>(f) the result of:</p> <p>(i) a Call Market Order,</p> <p>(ii) a Market-on-Close Order,</p> <p>(iii) a Volume-Weighted Average Price Order,</p> <p>(iv) a Basis Order, or</p> <p>(v) a Closing Price Order; or</p> <p>(g) a trade in an Exchange-traded Fund.</p> |
| <p>6.2 Designations and Identifiers</p> <p>(1) Each order entered on a marketplace shall contain: ...</p> <p>(b) a designation acceptable to the Market Regulator for the marketplace on which the order is entered, if the order is:</p> <p>(i) a Call Market Order,</p> <p>(ii) an Opening Order,</p> <p>(iii) a Market-on-Close Order,</p> <p>(iv) a Special Terms Order,</p> <p>(v) a Volume-Weighted Average Price Order,</p> <p>(v.1) a Basis Order,</p> <p>(v.2) a Closing Price Order,</p> <p>(vi) part of a Program Trade,</p> <p>(vii) part of an intentional cross or internal</p> | <p>6.2 Designations and Identifiers</p> <p>(1) Each order entered on a marketplace shall contain: ...</p> <p>(b) a designation acceptable to the Market Regulator for the marketplace on which the order is entered, if the order is:</p> <p>(i) a Call Market Order,</p> <p>(ii) an Opening Order,</p> <p>(iii) a Market-on-Close Order,</p> <p>(iv) a Special Terms Order,</p> <p>(v) a Volume-Weighted Average Price Order,</p> <p>(v.1) a Basis Order,</p> <p>(v.2) a Closing Price Order,</p> <p>(vi) part of a Program Trade,</p> |

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| <p>cross,</p> <p>(viii) a short sale,</p> <p>(ix) <i>[repealed]</i></p> <p>(x) a non-client order,</p> <p>(xi) a principal order,</p> <p>(xii) a jitney order,</p> <p>(xiii) for the account of a derivatives market maker,</p> <p>(xiv) for the account of a person who is an insider of the issuer of the security which is the subject of the order,</p> <p>(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</p> <p>(xvi) of a type for which the Market Regulator may from time to time require a specific or particular designation.</p> | <p>(vii) part of an intentional cross or internal cross,</p> <p>(viii) a short sale which is subject to the price restriction under subsection (1) of Rule 3.1,</p> <p>(ix) a short sale which is exempt from the price restriction on a short sale in accordance with subsection (2) of Rule 3.1,</p> <p>(x) a non-client order,</p> <p>(xi) a principal order,</p> <p>(xii) a jitney order,</p> <p>(xiii) for the account of a derivatives market maker,</p> <p>(xiv) for the account of a person who is an insider of the issuer of the security which is the subject of the order,</p> <p>(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</p> <p>(xvi) of a type for which the Market Regulator may from time to time require a specific or particular designation.</p> |
| <p>7.11 Failed Trades</p> <p>(1) If within ten trading days following the date for settlement contemplated on the execution of a failed trade, the account:</p> <p>(a) in the case of a sale, other than a short sale, that failed to make available securities in such number and form;</p> <p>(b) in the case of a short sale, that failed to make:</p> <p>(i) available securities in such number and form, or</p> <p>(ii) arrangements with the Participant or Access Person to borrow securities in such number and form; and</p> <p>(c) in the case of a purchase, that failed to make available monies in such amount,</p> <p>as to permit the settlement of the trade at the time on the date contemplated on the execution of the trade has not made available such securities or monies or has not made arrangements for the</p> | <p><u>7.11 Failed Trades</u></p> <p><u>(1) If within ten trading days following the date for settlement contemplated on the execution of a failed trade, the account:</u></p> <p><u>(a) in the case of a sale, other than a short sale, that failed to make available securities in such number and form;</u></p> <p><u>(b) in the case of a short sale, that failed to make:</u></p> <p><u>(i) available securities in such number and form, or</u></p> <p><u>(ii) arrangements with the Participant or Access Person to borrow securities in such number and form; and</u></p> <p><u>(c) in the case of a purchase, that failed to make available monies in such amount,</u></p> <p><u>as to permit the settlement of the trade at the time on the date contemplated on the execution of the trade has not made available such securities or monies or has not made arrangements for the</u></p> |

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| <p>borrowing of the securities, as the case may be, the Participant or Access Person that entered the order on a marketplace shall give notice to the Market Regulator at such time and in such form and manner and containing such information as may be required by the Market Regulator.</p> | <p><u>borrowing of the securities, as the case may be, the Participant or Access Person that entered the order on a marketplace shall give notice to the Market Regulator at such time and in such form and manner and containing such information as may be required by the Market Regulator.</u></p> |
| <p>(2) If a Participant or Access Person is required to provide notice of a failed trade to the Market Regulator in accordance with subsection (1), the Participant or Access Person shall, upon the account making available the applicable securities or monies or making arrangement for the borrowing of the applicable securities, give notice to the Market Regulator at such time and in such form and manner and containing such information as may be required by the Market Regulator.</p> | <p><u>(2) If a Participant or Access Person is required to provide notice of a failed trade to the Market Regulator in accordance with subsection (1), the Participant or Access Person shall, upon the account making available the applicable securities or monies or making arrangement for the borrowing of the applicable securities, give notice to the Market Regulator at such time and in such form and manner and containing such information as may be required by the Market Regulator.</u></p> |
| <p>7.12 Variation and Cancellation of Trades</p> <p>No trade executed on a marketplace shall, subsequent to the execution of the trade, be:</p> <p>(a) cancelled; or</p> <p>(b) varied with respect to:</p> <p>(i) the price of the trade,</p> <p>(ii) the volume of the trade, or</p> <p>(iii) the date for settlement of the trade,</p> <p>except:</p> <p>(c) by the Market Regulator in accordance with the Rules; or</p> <p>(d) with notice to the Market Regulator immediately following the variation or cancellation of the trade in such form and manner as may be required by the Market Regulator and such notice shall be given, if the variation or cancellation is made:</p> <p>(i) prior to the settlement of the trade, by:</p> <p>(A) the marketplace on which the trade was executed, or</p> <p>(B) the clearing agency through which the trade is or was to be cleared and settled, and</p> <p>(ii) after the settlement of the trade, by each Participant and Access Person that is a party to the trade.</p> | <p><u>7.12 Variation and Cancellation of Trades</u></p> <p><u>No trade executed on a marketplace shall, subsequent to the execution of the trade, be:</u></p> <p><u>(a) cancelled; or</u></p> <p><u>(b) varied with respect to:</u></p> <p><u>(i) the price of the trade,</u></p> <p><u>(ii) the volume of the trade, or</u></p> <p><u>(iii) the date for settlement of the trade,</u></p> <p><u>except:</u></p> <p><u>(c) by the Market Regulator in accordance with the Rules; or</u></p> <p><u>(d) with notice to the Market Regulator immediately following the variation or cancellation of the trade in such form and manner as may be required by the Market Regulator and such notice shall be given, if the variation or cancellation is made:</u></p> <p><u>(i) prior to the settlement of the trade, by:</u></p> <p><u>(A) the marketplace on which the trade was executed, or</u></p> <p><u>(B) the clearing agency through which the trade is or was to be cleared and settled, and</u></p> <p><u>(ii) after the settlement of the trade, by each Participant and Access Person that is a party to the trade.</u></p> |

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| <p>10.9 Power of Market Integrity Officials</p> <p>(1) A Market Integrity Official may, in governing trading in securities on the marketplace: ...</p> <p>(e.1) cancel any trade that is a failed trade in respect of which notice has been, or should have been, provided to the Market Regulator in accordance with Rule 7.11 if, in the opinion of such Market Integrity Official:</p> <p>(i) the account has failed to diligently pursue making available the applicable securities or monies or making arrangement for the borrowing of the applicable securities,</p> <p>(ii) there is no reasonable prospect that the failure will be rectified pursuant to the rules, requirements or procedures of the marketplace on which the trade was executed or the clearing agency through which the trade was to be settled, and</p> <p>(iii) the cancellation of the trade is appropriate in the interest of a fair and orderly market; ...</p> | <p>10.9 Power of Market Integrity Officials</p> <p>(1) A Market Integrity Official may, in governing trading in securities on the marketplace: ...</p> <p><u>(e.1) cancel any trade that is a failed trade in respect of which notice has been, or should have been, provided to the Market Regulator in accordance with Rule 7.11 if, in the opinion of such Market Integrity Official:</u></p> <p><u>(i) the account has failed to diligently pursue making available the applicable securities or monies or making arrangement for the borrowing of the applicable securities,</u></p> <p><u>(ii) there is no reasonable prospect that the failure will be rectified pursuant to the rules, requirements or procedures of the marketplace on which the trade was executed or the clearing agency through which the trade was to be settled, and</u></p> <p><u>(iii) the cancellation of the trade is appropriate in the interest of a fair and orderly market;</u> ...</p> |
| | <p>10.10 Report of Short Positions</p> <p>(1) A Participant shall calculate, as of 15th day and as of the last day of each calendar month, the aggregate short position of each individual account in respect of each listed security and quoted security.</p> <p>(2) Unless a Participant maintains the account in which an Access Person has the short position in respect of a listed security or quoted security, the Access Person shall calculate, as of the 15th day and as of the last day of each calendar month, the aggregate short position of the Access Person in respect of each listed security and quoted security.</p> <p>(3) Unless otherwise provided, each Participant and Access Person required to file a report in accordance with subsection (1) or (2) shall file a report of the calculation with a Market Regulator in such form as may be required by the Market Regulator not later than two trading days following the date on which the calculation is to be made.</p> |
| <p>Policy 1.1 Definitions</p> <p>Part 3 – Definition of “Short Sale”</p> <p>Under the definition of “short sale”, a seller shall be considered to own a security under various circumstances including if the seller:</p> | <p>Policy 1.1 Definitions</p> <p><u>Part 3 – Definition of “Short Sale”</u></p> <p><u>Under the definition of “short sale”, a seller shall be considered to own a security under various circumstances including if the seller:</u></p> |

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| <ul style="list-style-type: none"> • owns directly or through an agent or trustee another security that is convertible or exchangeable into that security and has tendered such other security for conversion or exchange or has issued irrevocable instructions to convert or exchange such other security; • has an option to purchase the security and has exercised the option; or • has a right or warrant to subscribe for the security and has exercised the right or warrant. <p>In each of these circumstances, the seller must have taken all steps necessary to become legally entitled to the security, including having:</p> <ul style="list-style-type: none"> • made any payment required; • submitted to the appropriate person any required forms or notices; and • submitted, if applicable, to the appropriate person any certificates for securities to be converted, exchanged or exercised. | <ul style="list-style-type: none"> • <u>owns directly or through an agent or trustee another security that is convertible or exchangeable into that security and has tendered such other security for conversion or exchange or has issued irrevocable instructions to convert or exchange such other security;</u> • <u>has an option to purchase the security and has exercised the option; or</u> • <u>has a right or warrant to subscribe for the security and has exercised the right or warrant.</u> <p><u>In each of these circumstances, the seller must have taken all steps necessary to become legally entitled to the security, including having:</u></p> <ul style="list-style-type: none"> • <u>made any payment required;</u> • <u>submitted to the appropriate person any required forms or notices; and</u> • <u>submitted, if applicable, to the appropriate person any certificates for securities to be converted, exchanged or exercised.</u> |
| <p>POLICY 2.1 – Just and Equitable Principles</p> <p>Part 1 – Examples of Unacceptable Activity</p> <p>...</p> <p>Participants and Access Persons who intentionally organize their business and affairs with the intent or for the purpose of avoiding the application of a Requirement may be considered to have engaged in behaviour that is a failure to conduct business openly and fairly or in accordance with just and equitable principles of trade. For example, the Market Regulator considers that a person who is under an obligation to enter orders on a marketplace who “uses” another person to make a trade off of a marketplace (in circumstances where an “off-market exemption” is not available) to be violating the requirement to conduct business openly and fairly or in accordance with just and equitable principles of trade. Similarly, the Market Regulator considers that a person who enters into a transaction for the purpose of rectifying a failure in connection with a failed trade prior to the time that a report must be filed in accordance with Rule 7.11 and such person knows or ought reasonably to know that such transaction will result in a failed trade to be engaging in “re-aging” for the purpose of avoiding reporting obligations contrary to the requirement to conduct business openly and fairly or in accordance with just and equitable principles of trade.</p> <p>...</p> | <p>POLICY 2.1 – Just and Equitable Principles</p> <p>Part 1 – Examples of Unacceptable Activity</p> <p>...</p> <p>Participants and Access Persons who intentionally organize their business and affairs with the intent or for the purpose of avoiding the application of a Requirement may be considered to have engaged in behaviour that is contrary to <u>a failure to conduct business openly and fairly or in accordance with</u> just and equitable principles of trade. For example, the Market Regulator considers that a person who is under an obligation to enter orders on a marketplace who “uses” another person to make a trade off of a marketplace (in circumstances where an “off-market exemption” is not available) to be violating <u>the requirement to conduct business openly and fairly or in accordance with</u> just and equitable principles of trade. <u>Similarly, the Market Regulator considers that a person who enters into a transaction for the purpose of rectifying a failure in connection with a failed trade prior to the time that a report must be filed in accordance with Rule 7.11 and such person knows or ought reasonably to know that such transaction will result in a failed trade to be engaging in “re-aging” for the purpose of avoiding reporting obligations contrary to the requirement to conduct business openly and fairly or in accordance with just and equitable principles of trade.</u></p> <p>...</p> |

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| | <p>Policy 3.1— Restrictions on Short Selling</p> <p>Part 1— Entry of Short Sales Prior to the Opening</p> <p>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).</p> |
| | <p>Policy 3.1— Restrictions on Short Selling</p> <p>Part 2— Short Sale Price When Trading Ex-Distribution</p> <p>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).</p> <p>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).</p> <p>Once a security has traded on an ex-distribution basis, the regular short sale rule applies and the relevant price is the previous trade.</p> |