mcmillan

Date: February 22, 2023

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission (New Brunswick)
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Office of the Superintendent of Securities, Service NL
Northwest Territories Office of the Superintendent of Securities
Office of the Yukon Superintendent of Securities
Superintendent of Securities, Nunavut
New Self-Regulatory Organization of Canada

Me Philippe Lebel
Secrétaire et directeur général des affaires juridiques
Autorité des marchés financiers
Place de la Cité, tour Cominar
2640, boulevard Laurier, bureau 400, Québec, Québec G1V 5C1
consultation-en-cours@lautorite.qc.ca

The Secretary
Ontario Securities Commission
20 Queen Street West, 22nd floor, Toronto, Ontario M5H 3S8
comments@osc.gov.on.ca

Dear Sirs/Mesdames,

Re: Comments with respect to the Joint Canadian Securities Administrators (the "**CSA**") and the Investment Industry Regulatory Organization of Canada ("**IIROC**") Staff Notice 23-329 – *Short Selling in Canada* (the "**Staff Notice**")

We are writing in response to the request for comments by the CSA and IIROC[1] with respect to the questions set out in the Staff Notice published on December 8, 2022.[2] We begin with the following, which help guide some of our responses:

- a general comment on our approach to short selling regulation in Canada;

[1] Note that as of January 3, 2023, IIROC and the Mutual Fund Dealers Association of Canada officially amalgamated to become the New Self-Regulatory Organization of Canada. In this comment letter, we continue to use "IIROC" to refer to publications released by IIROC prior to the amalgamation.
[2] CSA, *Joint CSA and IIROC – Staff Notice 23-329 Short Selling in Canada* (8 December 2022), online (pdf): *Canadian Securities Administrators and Investment Industry Regulatory Organization of Canada* <https://www.osc.ca/sites/default/files/2022-12/csa-iiroc_20221208_23-329_short-selling.pdf> [*Staff Notice*].

- a reiteration of the need for a private right of action;
- a brief overview of the critical legal milestones of IIROC with respect to regulating short selling in Canada and its rationale for these regulations;
- a review of the new failed trade study released by IIROC on December 8, 2022 (the "**2022 Failed Trade Study**");[3] and
- an analysis of the data presented in CSA Staff Notice 25-306 – *Activist Short Selling Update* (the "**Activist Short Selling Update**"), which led staff of the CSA to conclude that less than 1% of all Canadian issuers have been the target of activist short selling campaigns, in comparison to 3% of all United States (the "**U.S.**") issuers.[4]

We then respond to each of the questions posed in the Staff Notice.

The views, opinions and recommendations expressed in this letter are solely those of the lawyers whose names are set out at the conclusion of this letter, and are not made on behalf of McMillan LLP, or its clients. We would be pleased to provide further insight and additional details with respect to our submissions, and would welcome the opportunity to engage further with the CSA and the New Self-Regulatory Organization of Canada.

Systemic Risk

As first set forth in further detail in a paper authored by lawyers at our firm on short selling regulation in Canada, *An Analysis of the Short Selling Landscape in Canada* (the "**2019 Short Selling Paper**"),[5] and subsequently in our comment letter (the "**2021 Comment Letter**")[6] in response to CSA Consultation Paper 25-403 – *Activist Short Selling*,[7] our analysis and recommendations have always been guided by the stated goals of the CSA to improve investor confidence and market efficiency and lessen systemic risk.

To reiterate, when we reference systemic risk, we mean the risk of a significant disruption of one or more of the core functions of the financial system caused by the initial failure of one or more firms or a segment of the financial system. Addressing system risk requires proactive,

[3] IIROC Failed Trade Study (8 December 2022), online: *Investment Industry Regulatory Organization of Canada* <https://www.iiroc.ca/news-and-publications/notices-and-guidance/iiroc-failed-trade-study> [*2022 Failed Trade Study*].
[4] CSA Staff Notice 25-306 – *Activist Short Selling Update* (8 December 2022), online (pdf): Ontario Securities Commission <https://www.osc.ca/sites/default/files/2022-12/csa_20221208_25-306_short-selling.pdf> [*Activist Short Selling Update*].
[5] P. Davis et al, *An Analysis of the Short Selling Landscape in Canada: a New Path Forward is Needed to Improve Market Efficiency and Reduce Systemic Risk* (October 2019), online (pdf): <http://mcmillan.ca/wp-content/uploads/2020/07/An-Analysis-of-the-Short-Selling-Landscape-of-Canada-Digital.pdf> [*2019 Short Selling Paper*].
[6] P. Davis et al, *McMillan Comment Letter Re: CSA Consultation Paper 25-403 – Activist Short Selling* (3 March 2021), online (pdf): *Ontario Securities Commission* <https://www.osc.ca/sites/default/files/2021-03/com_20210303_25-403_mcmillan.pdf> [*2021 Comment Letter*].
[7] CSA Consultation Paper 25-403 – *Activist Short Selling* (3 December 2020), online (pdf): *Canadian Securities Administrators* <https://www.osc.ca/sites/default/files/2020-12/csa_20201203_25-403_activist-short-selling.pdf>.

forward-looking regulation as opposed to reactive, after-the-fact measures. When assessing the presence of systemic risk, the question is not whether examples of systemic risk *have* been found, but whether there exists the possibility of development of such risk. We continue to believe that the existing regulatory framework does not adequately address systemic risk related to short selling in the Canadian capital markets for the reasons set out in our 2019 Short Selling Paper.[8] We are hopeful that this new consultation process culminates in more proactive regulation.

Notwithstanding our call for more thoughtful regulation, we wish to emphasize that we are not opposed to short selling. In fact, we believe that short selling is critical to the vibrancy of our capital markets – short selling improves liquidity and enhances or facilitates price discovery and market efficiency, and can also prevent or mitigate market bubbles.

Private Right of Action

While not specifically the subject matter of the Staff Notice, we continue to advocate for a statutory private right of action for target corporations and their security holders against short sellers who can be proven to have engaged in a short and distort campaign. We identified in our 2019 Short Selling Paper a number of obstacles for target corporations and their security holders with respect to private law remedies for short campaigns, and believe such remedies are ill-suited to address the economic losses suffered by shareholders and issuers as a result of a short and distort campaign.[9]

We first proposed the framework for such a private right of action in our 2019 Short Selling Paper.[10] However, and as also outlined in our 2021 Comment Letter, we caution that any private right of action must be based on a short seller's deliberate and calculated conduct, and not mere negligence, or a good-faith mistake.[11]

IIROC's Key Rules and Rationale

This section provides a brief overview of the critical legal milestones of IIROC with respect to regulating short selling in Canada and its rationale for these changes.

[8] *2019 Short Selling Paper, supra* note 5 at Sections 3.2.5, 7 and 8.
[9] *Ibid* at Section 7.7.1.
[10] *2021 Comment Letter, supra* note 6 at 18.
[11] *Ibid* at 18-21. See also *2019 Short Selling Paper*, *supra* note 5 at Section 7.7.3.

Adoption of UMIR

In 2002,[12] Market Regulation Services Inc. ("**RS**"), a predecessor organization to IIROC, adopted the Universal Market Integrity Rules ("**UMIR**") which imposed requirements on Participants (as defined in UMIR)[13] to:

(i) "prohibit the short selling of a security on a marketplace unless the price is at or above the last sale price (tick test or tick rule);

(ii) designate orders and trades as short sales on a marketplace; and

(iii) file short position reports".[14]

As noted in the Staff Notice, the short selling rules being implemented in 2002 were already in place on the exchanges that retained RS to act as a regulation services provider[15] – such as the Toronto Stock Exchange.

Introduction and Development of the Reasonable Expectation Standard

In 2005, through the changes to the policies in connection with UMIR 2.2 ("**Policy 2.2**"), IIROC introduced the reasonable expectation standard which imposed a requirement that anyone entering into a short sale could only do so with a reasonable expectation of their ability to settle the trade (the "**Reasonable Expectation of Settlement Requirement**").[16] When RS published its proposed changes to Policy 2.2 for comments in 2004, RS explained the reasons for the amendments which included:

(i) "to move the specific examples of prohibited activities from the rules to the policies to be consistent with the structure of the rules in UMIR"; and

(ii) "to expand the list of specific examples to include a prohibition on entering orders without the ability or the reasonable expectation of making settlement of the resulting trade".[17]

---

[12] *Market Integrity Notice 2002-003* (1 April 2002), print: *Market Regulation Services Inc.*
[13] Annotated Universal Market Integrity Rules (7 November 2018) at 1.1, online (pdf): *Investment Industry Regulatory Organization of Canada* <https://www.iiroc.ca/media/1021/download?inline> [*UMIR*]
[14] *Staff Notice, supra* note 2 at Appendix A. See also Appendix B – Text of the Universal Market Integrity Rules of the Recognition Order of Market Regulation Services Inc., effective February 14, 2002.
[15] *Ibid*.
[16] See *Notice of Amendment Approval: Provisions Respecting Manipulative and Deceptive Activities*, Market Integrity Notice 2005-011 (1 April 2005) at 4, online (pdf): *Investment Industry Regulatory Organization of Canada* <https://www.iiroc.ca/media/5496/download?inline>.
[17] *2019 Short Selling Paper, supra* note 5 at 30. See also *Request for Comments: Manipulative and Deceptive Activities*, Market Integrity Notice 2004-003 (30 January 2004).

On August 17, 2022, IIROC published a Staff Notice 22-0130: *Guidance on Participant Obligations to Have Reasonable Expectation to Settle any Trade Resulting from the Entry of a Short Sale Order* (the "**Guidance**") to provide additional clarity and guidance with respect to the Reasonable Expectation of Settlement Requirement.[18] The Guidance outlined specific examples of what constitutes a "reasonable expectation" in regards to having sufficient securities available on settlement date. For instance, IIROC indicated that to meet the "reasonable expectation" standard, a Participant is expected to have "reasonable certainty" that it can access sufficient securities to settle any resulting trade by the settlement date and that a vendor must not enter a short sale order if it "knows or ought reasonably to know" that sufficient securities will not likely be available for settlement.[19] We note that IIROC did not provide any rationale for the issuance of the Guidance.

2008 UMIR Amendments - Short Sale Ineligible Security

In 2008, UMIR was amended to provide IIROC with the power to designate a security as a "Short Sale Ineligible Security" in order to respond to developments in trading of a particular security or class of securities if IIROC concluded that the rates of failed trades became excessive.[20] The designation of a security as a Short Sale Ineligible Security is intended to function with existing rules, such as the market integrity rules in Policy 2.2, as well as the CSA's expectations set out in National Instrument 24-101 – *Institutional Trade Matching and Settlement*.[21]

2011 UMIR Amendments – Extended Failed Trade Reporting

In 2011, IIROC adopted amendments to UMIR requiring Participants and Access Persons (as defined in UMIR)[22] to file an extended failed trade report ("**EFTR**") with IIROC or other market regulators if a trade remained unsettled for 10 trading days following the expected settlement

[18] IIROC Staff Notice 22-0130- *Guidance on Participant Obligations to Have Reasonable Expectation to Settle any Trade Resulting from the Entry of a Short Sale Order* (17 August 2022) at Executive Summary, online: *Investment Industry Regulatory Organization of Canada* <https://www.iiroc.ca/news-and-publications/notices-and-guidance/guidance-participant-obligations-have-reasonable-expectation-settle-any-trade-resulting-entry-short> [*The Guidance*].
[19] *Ibid* at 2.
[20] See also IIROC Notice 08-0143: *Rules Notice – Notice of Approval – Provisions Respecting Short Sales and Failed Trades*, (15 October 2008) at Additional Restrictions on Short Sales, online: *Investment Industry Regulatory Organization of Canada* <https://www.iiroc.ca/news-and-publications/notices-and-guidance/provisions-respecting-short-sales-and-failed-trades-0> [*Notice 08-0143*]; and *Request for Comments – Provisions Respecting Short Sales and Failed Trades*, Market Integrity Notice 2007-017 (7 September 2007) at 13, online (pdf): *Market Regulation Services*<https://www.osc.ca/sites/default/files/2021-01/srr-rs_20070907_rfc-short-sales.pdf> [*Integrity Notice 2007-017*].
[21] *2019 Short Selling Paper, supra* note 5 at 32. See also *Notice 08-0143, supra* note 20 and *Integrity Notice 2007-017, supra* note 20 at Additional Restrictions on Short Sales.
[22] *UMIR*, *supra* note 13 at 1.1.

date.[23] IIROC noted that the amendments proposed in 2008 – which included the proposed EFTR filing requirements – were built on its 2007 failed trade study (the "**2007 Failed Trade Study**") which found that:

(i) failed trades accounted for 0.27% of the total number of trades executed;

(ii) less than 6% of fails resulted from short sales; and

(iii) approximately 96% of failed trades settled within 10 trading days.[24]

In addition, IIROC concluded that requiring EFTR filings at the account level – and for all trades – would allow it to examine if a trade failed to settle for an "improper reason", such as being executed as an undeclared short.[25] As part of the EFTR filing requirements, the filing of a second "close-out" report would be required once the trade settled.[26] IIROC explained that "[i]n this way, [IIROC] 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".[27]

2012 UMIR Amendments – Limited Pre-Borrowing Requirements

In 2012, UMIR was amended to provide IIROC with the power to designate a security as a "Pre-Borrow Security" if trading in that particular security had a history of extended failed trades. UMIR was also amended to impose a requirement on Participants and Access Persons to make arrangements to borrow designated Pre-Borrow Securities.[28]

In addition, IIROC required Participants and Access Persons trading as principals, as well as their customers, to borrow or arrange securities based on a history of extended failed trades. Participants or Access Persons were now required to pre-borrow securities in the following circumstances:

---

[23] IIROC implemented the EFTR requirements for all trades executed on a marketplace and settle through: (i) the continuous net settlement facilities (CNS) on June 1, 2011 (IIROC Notice 11-0161: *Reminder Regarding the Reporting of Extended Failed Trades* (19 May 2011) at 1, online: *Investment Industry Regulatory Organization of Canada* <https://www.iiroc.ca/news-and-publications/notices-and-guidance/reminder-regarding-reporting-extended-failed-trades>.) and (ii) the trade-for-trade ("TFT") facility of CDS on April 15, 2013 (IIROC Notice 13-0014: *Implementation Date for Reporting "Trade-for-Trade" Extended Failed Trades* (14 January 2013), online: *Investment Industry Regulatory Organization of Canada* <https://www.iiroc.ca/news-and-publications/notices-and-guidance/implementation-date-reporting-trade-trade-extended-failed-trades>).

[24] *Integrity Notice 2007-017, supra* note 20 at 8-9. See also Statistical Study of Failed Trades on Canadian Marketplaces – Report (April 2007) at 6, print [*2007 Failed Trade Study*].

[25] *Integrity Notice 2007-017, supra* note 20 at 15.

[26] *Ibid*.

[27] *Ibid*.

[28] IIROC Notice 11-0075: *Request for Comments – Provisions Respecting Regulation of Short Sales and Failed Trades* (25 February 2011) at Pre-Borrow Requirements, online (pdf): *Investment Industry Regulatory Organization of Canada* <https://www.iiroc.ca/media/9556/download> [*Notice 11-0075*].

- Participants, acting as agent for a client or non client with a prior extended failed trade on any listed security, are required to make arrangements to borrow securities necessary to settle the resulting trade before entering into an order for a short sale for the client or non-client, unless: (a) the Participant makes reasonable inquiries and is satisfied that the reason for the prior failed trade was solely due to administrative error (and not an intentional or negligent act), or (b) IIROC consents to the sale.[29]
- Participants acting as principal and Access Persons who have a prior extended failed trade for a particular security cannot enter into an order for the short sale of that security, unless it makes arrangements to borrow the securities necessary to settle the resulting trade before it enters the order, unless IIROC consents to the sale.[30]

Concurrent with the issuance of the request-for-comments relating to the pre-borrowing requirements, IIROC published a multi-year study from May 2007 to April 2010 (the "**2011 Trends Study**") which expanded on the 2007 Failed Trade Study in some respects. Amongst key findings, the 2011 Trends Study found that short sales remained relatively constant throughout the study period and that the number of failed trades had generally declined.[31]

When IIROC provided commentary on the proposed amendments in the context of the International Organization of Securities Commissions ("**IOSCO**") Principle 1 (see below), IIROC noted that its studies "have demonstrated that, in Canada, a short sale has a lower probability of settlement failure than trades generally and that the primary reason for trade failure is simple 'administrative error'".[32] IIROC also noted that EFTR rules (which were in the process of being implemented at the time) would provide IIROC with a mechanism to follow-up directly with problematic trades.[33]

The 2022 Failed Trade Study

We commend IIROC for conducting an updated failed trade study. The 2022 Failed Trade Study is a significant step forward from the 2007 Failed Trade Study. The 2022 Failed Trade Study provides helpful data, and represents a strong starting point for empirical decision making with respect to the regulation of short selling and failed trades.

We note that while the 2022 Failed Trade Study was comprehensive, it generally does not provide an update on the data in the 2007 Failed Trade Study, thus making comparisons of the two studies challenging. For example, the 2007 Failed Trade Study provided data with respect to failed trades as a percentage of total trades, whereas the 2022 Failed Trade Study

[29] IIROC Notice 12-0078 – *Notice of Approval – Provisions Respecting Regulation of Short Sales and Failed Trades* (2 March 2012) at 2.2, online: *Investment Industry Regulatory Organization of Canada* <https://www.iiroc.ca/news-and-publications/notices-and-guidance/provisions-respecting-regulation-short-sales-and-failed-trades> [*Notice 12-0078*].
[30] *Ibid*.
[31] *Trends in Trading Activity Short Sales and Failed Trades (2007-2010)* (February 2011) at 32, print: *Investment Industry Regulatory Organization of Canada* [*2011 Trends Study*].
[32] *Notice 11-0075, supra* note 28 at IOSCO Principle 1.
[33] *Ibid*.

concerns itself with the volume of shares underlying such trades.[34] Additionally, the 2007 Failed Trade Study provided data with respect to the reasons underlying failed trades for all failed trades (i.e. trades which do not settle on the expected settlement date), not just "extended failed trades" ("**EFTs**") which had not settled within ten days of the expected settlement date as set out in the 2022 Failed Trade Study — making it impossible to determine if failed trades were mostly a result of "administrative delay or error" — a key finding from the 2007 Failed Trade Study.[35]

One area in which the 2022 Failed Trade Study provides updated data to the 2007 Failed Trade Study is with respect to the length of time failed trades take to settle. The 2007 Failed Trade Study found that 88% of failed trades settled within five days after the expected settlement date and approximately 96% of failed trades settled within 10 days of the expected settlement date.[36] Based on the 2022 Failed Trade Study, approximately 93% of Trade-for-Trade ("**TFT**") failed trade volume settled within five days after the expected settlement date, with 98% of failed trade volume settling within 10 days of the expected settlement date.[37] This provides some confirmation of the data in the 2007 Failed Trade Study with respect to the length of time during which failed trades are outstanding. We note, however, that as recognized by IIROC, most transactions settle through Clearing and Depository Services Inc.'s ("**CDS**") Continuous Net Settlement service ("**CNS**"), and as a result, the TFT data may not be representative of the broader market.[38]

The 2011 Trends Study showed that while the value of short sales as a percentage of total traded value increased over the study period of the 2011 Trends Study, the value of accumulated fails as a percentage of total traded value decreased.[39] From this, IIROC concluded that such a trend casted doubt on whether there was a relationship between short sales and failed trades, as was perceived in the U.S. However, as we have previously noted,[40]

---

[34] *2007 Failed Trade Study, supra* note 24 at 5; *2022 Failed Trade Study, supra* note 3 at 12.
[35] *2007 Failed Trade Study, supra* note 24 at 6.
[36] *Ibid* at 11.
[37] The 2022 Failed Trade Study, *supra* note 3 at 10, provided data in Figure 3 with respect to the percentage of TFT transaction volume that had settled on each date following the expected settlement date. The 2022 Failed Trade Study also provided the percentage of TFT volume which settled on the expected settlement date. We have used a combination of the Figure 3 data and the expected settlement date volume data in these calculations. We note that these averages equally weigh volume on each of the four exchanges, but it is likely that TSX volume accounted for a greater percentage of volume, and as a result, the percentages which we have provided are likely in actuality higher. Additionally, at the time of the 2007 Failed Trade Study, settlement was mandated on T+3. At the time of the 2022 Failed Trade Study, settlement is mandated at T+2. Adjusting the 2022 Failed Trade Study data to reflect a T+3 settlement cycle reveals that approximately 84% of failed trade volume had settled five days following settlement, and that approximately 95% of failed trade volume settled nine days following settlement.
[38] *Staff Notice, supra* note 2 at 3 (footnote 23).
[39] *Notice 11-0075, supra* note 28 at Summary of Empirical Studies by IIROC.
[40] *2019 Short Selling Paper, supra* note 5 at 137. See also CSA Consultation Paper 24-402: *Policy Considerations for Enhanced Settlement Discipline in a T+2 Settlement Cycle Environment* (18 August 2016) at 25, online (pdf): *Alberta Securities Commission* www.albertasecurities.com/-/media/ASCDocuments-part-1/Regulatory-Instruments/2018/10/5313054-Consultation-Paper-24-402.ashx [*Consultation Paper 24-402*].

in 2016 the CSA reviewed CNS failed trade data from May 1, 2007 to March 31, 2016, extending the study period in the 2011 Trends Study. The CSA found that "the declining trend in CNS fail rates appears to have abated, with cumulative CNS fails remaining relatively stable and generally below 2% of the aggregate value of trades".[41] We would have expected updated data to be provided with respect to the value of failed trades and the value of short sale trades, in order to test whether there had been any change in the relationship between the value of failed trades and short sale trades, which may lead to a differing conclusion than the one drawn by IIROC from its 2011 Trends Study.

We believe that the 2022 Failed Trade Study merits a revisiting of certain of the foundational assumptions made by IIROC in establishing the current Canadian short selling regulatory regime. IIROC has stated in the past that, in effect, short selling is not a factor in failed trades.[42] However, the 2022 Failed Trade Study seems to suggest the opposite, noting that "the percentage of securities with a strong positive correlation between CNS failure and short positions reported to IIROC is high (28% to 34%) for all listed securities".[43] The 2022 Failed Trade Study also found that "failure to settle TSXV- and CSE-listed securities is more closely related to the volume of short selling or a related underlying factor (like the total amount of trading)…".[44] These findings call into question IIROC's initial conclusion that "results of the [2007 Failed Trade Study] supports the conclusion that failed trades, and failed trades resulting from short sales, are not a widespread phenomenon in the Canadian marketplace".[45]

Additionally, IIROC's 2007 Failed Trade Study found that failed trades comprised only 0.27% of total trades, however, notwithstanding this finding, the 2022 Failed Trade Study suggests that as a percentage of total traded volume on the CNS system, failed trade volume ranges from approximately 3% to 19%, depending on the exchange.[46] This suggests that, in contrast to the 2007 Failed Trade Study, failed trades or at least failed trade share volume, may be a more significant phenomenon in the Canadian capital markets than initially surmised by IIROC. Moreover, based on the 2022 Failed Trade Study, for TFT settled trades, approximately 1 in 4 shares are not delivered on the settlement date on the CSE and NEO, while

[41] *Consultation Paper 24-402, supra* note 40 at 25.
[42] See *2007 Failed Trade Study, supra* note 24 at 13: "…results of the [2007 Failed Trade Study] supports the conclusion that failed trades, and failed trades resulting from short sales, are not a widespread phenomenon on Canadian marketplaces". See *2011 Trends Study, supra* note 31: "a short sale is less likely to fail than a trade generally…". IIROC noted strong correlations between the amount of short selling and CNS failure as well as "some relationship" between short selling activity and "some combination of partial settlements, netting, or dealer-instigated buy-ins" with respect to TFT transactions for TSX-listed securities, in the 2022 Failed Trade Study.
[43] *2022 Failed Trade Study, supra* note 3 at 12.
[44] *Ibid* at 12-13. While the 2022 Failed Trade Study showed that a relatively smaller percentage of securities have a strong positive correlation between V+10 TFT settled volume and short positions, we note that IIROC highlighted in the 2022 Failed Trade Study that TFT transactions often settle to non-IIROC entities, which are not obligated to provide short positions to IIROC, and that the real relationship between V+10 TFT settled volume and short positions could be different from the study results.
[45] *2007 Failed Trade Study, supra* note 24 at 13.
[46] *2022 Failed Trade Study, supra* note 3 at Table 1. Note that "total trades" refers to trades executed on the TSX, TSXV, and the CNQ (now the CSE).

approximately 1 in 5 shares are not delivered on the settlement date on the TSX-V.[47] Again, this highlights the limitations of the 2007 Failed Trade Study and the concerns which we have previously expressed about the use of the 2007 Failed Trade Study as a basis for policy making.[48]

Another key finding made by IIROC in the 2007 Failed Trade Study was that a short sale is less likely to fail than a trade generally.[49] Notwithstanding this important finding, the 2022 Failed Trade Study does not provide data with respect to likelihood of trade failure by type of sale. We would have expected the 2022 Failed Trade Study to provide an update to market participants on this key finding.

Ultimately, while the 2022 Failed Trade Study is helpful in providing current data, it is not possible to draw meaningful comparisons between the 2022 Failed Trade Study and the 2007 Failed Trade Study and assess whether IIROC's conclusions from the 2007 Failed Trade Study were correct, or remain correct, and thus form an appropriate basis for the current regime. Moreover, as we highlighted above, the 2022 Failed Trade Study does appear to suggest, at a minimum, a correlation between settlement problems and short selling, and we believe that further research is required to determine whether there is causation present, or whether there is some other underlying root cause.

Naked Short Selling and the IOSCO Principles

In early 2009, IOSCO's Technical Committee issued its report *Regulation of Short Selling*. The committee consisted of representatives of the Ontario Securities Commission and the Autorité des marchés financiers. In the report, IOSCO recommended four principles for the effective regulation of short sales by securities regulators aimed at eliminating perceived gaps between differing regulatory approaches to naked short selling. A brief overview of the four principles (the "**IOSCO Principles**") and our concerns as they relate to IOSCO Principles 1 and 2 are set out below:[50]

> **IOSCO Principle 1**: Short selling activities should be subject to appropriate controls to reduce or minimize the potential risks that could affect the orderly and efficient functioning and stability of the capital markets. IOSCO recommended that the "regulation of short selling should *as a minimum requirement impose a strict settlement (such as compulsory buy-in) of failed trades*" [emphasis in original].[51] IOSCO also noted that some jurisdictions have compulsory buy-in or close-out requirements, supported

[47] Based on an analysis of data as provided in *2022 Failed Trade Study, supra* note 3 at Figure 3.
[48] *2019 Short Selling Paper, supra* note 5 at Section 7.4.1.
[49] *2011 Trends Study, supra* note 31 at 32.
[50] *Notice 11-0075, supra* note 28 at Appendix C.
[51] *Regulation of Short Selling*, Consultation Report, (March 2009) at Section 3, online (pdf): *Technical Committee of the International Organization of Securities Commissions* www.iosco.org/library/pubdocs/pdf/IOSCOPD289.pdf [*IOSCO Principles*].

by mandatory pre-borrowing, or locate requirements, as well as T+3 as the standard settlement cycle.[52]

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

IOSCO Principle 3: Short selling should be subject to an effective compliance and enforcement regime. IOSCO noted that regulators should monitor and inspect settlement failures regularly, implement a "flagging" regime and identify potential market abuses and systemic risk.

IOSCO Principle 4: Short selling regulation should allow appropriate exceptions for certain types of transactions for efficient market functioning and development. IOSCO expressed concern that short selling regulation allows desirable market transactions and that there should be clear definitions of exempted activities and the manner in which these activities should be reported.

In response to IOSCO Principle 1, IIROC has historically maintained that the unique attributes of Canadian capital markets negate the need for front-end locate or pre-borrow requirements or back-end compulsory buy-ins.[53] In particular, it has been noted that Policy 2.2 of UMIR and the Reasonable Expectation of Settlement Requirement provide adequate measures against abusive short selling practices.[54] IIROC also concluded that "hard" close-out provisions are not appropriate based on the 2007 Failed Trade Study's finding that most trade failures are the result of administrative errors.[55] Similarly, in IIROC's view, historic low trade failure rates make it unnecessary to impose general locate or pre-borrow requirements.[56]

As noted above, evidence from the more recent 2022 Failed Trade Study runs contrary to IIROC's conclusions. The 2022 Failed Trade Study indicates that the prevalence of failed trades may actually range from 3% to 19% of total CNS traded volume, depending on the exchange—much greater than the 2007 Failed Trade Study's figure of 0.27%.[57] The 2022 Failed Trade Study also concluded that EFTRs showed that short selling related reasons were significant factors in settlement failures and that there were strong correlations between short selling and CNS settlement issues.[58] Further, although no official rationale was given for the Guidance released in August 2022 by IIROC, the elevation of the standard for the "reasonable

[52] Since the publication of IOSCO's report, the standard settlement cycle has been changed to T+2.
[53] *2019 Short Selling Paper, supra* note 5 at Section 8.3.
[54] *Ibid* at Section 3.2.6.
[55] *Ibid* at Section 3.2.6.
[56] *Ibid* at Section 3.2.6.
[57] *2022 Failed Trade Study*, *supra* note 3 at Table 1; See also *Notice 11-0075*, *supra* note 28 at Summary of Empirical Studies by IIROC.
[58] *2022 Failed Trade Study*, *supra* note 3 at 15.

expectation of settlement" requirement to a "reasonable certainty" level suggests that additional measures were (and are) necessary to prevent naked short selling.

IOSCO Principle 2 calls for increased transparency surrounding short selling.[59] At present, a limited set of short data is made public every two weeks by IIROC, which does not adequately fulfill the purpose behind this principle. We believe that, given the potential for short selling to inflict harm on markets and the economy, more timely disclosure of short positions and adding new reporting on delivery failures is necessary. Additionally, such changes would provide better congruency between the availability of long position data and short position data. Most importantly, dissemination of information to the market regarding short activity provides important mitigation of systemic risk by ensuring that the market is made aware, in a timely fashion, of any potentially abusive short selling activity and that regulators and market participants can respond accordingly. For further information on our recommendations regarding timing of disclosure, please see our response to question 5.

CSA Staff Notice 25-306 – Activist Short Selling Update

In December 2022, the CSA published the Activist Short Selling Update. In section 3, part B, the CSA discusses "Recent Activist Short Selling Activity", noting that as at October 7, 2022, seven Canadian issuers have been the target of activist short seller campaigns since the start of the year, whereas 50 U.S. issuers have been targeted by activist short sellers over the same time period.[60]

However, upon re-examining this data using the same sources that the CSA cites (Activist Insider, now Insightia, and the World Federation of Exchanges ("**WFE**")) we noted some discrepancies with this data. It appears that instead of using *issuers* targeted by campaigns, this data in reality reflects the number of campaigns launched. As at October 7, 2022, Insightia reported seven *campaigns* launched against Canadian issuers, but only six total issuers targeted (as certain issuers were targeted by multiple campaigns).[61] In comparison, during the same time period there were 52 *campaigns* launched against U.S. issuers, but only 20 total issuers targeted.[62]

The CSA also notes that "less than 1% of all Canadian issuers have been the target of activist short selling campaigns. In comparison, 3% of all U.S issuers…have been the target of similar activist short selling campaigns".[63] This is calculated, presumably, by comparing the figure indicated above against the annual listed issuer count from WFE. However, the WFE does not list the total number of issuers per country, but rather the annual count of listed issuers from *certain exchanges*—in Canada, WFE only has complete data for the past decade for the TMX

[59] *Notice 11-0075*, *supra* note 28 at Appendix C. See also *IOSCO Principles, supra* note 51 at Section 3.17.
[60] *Activist Short Selling Update, supra* note 4 at Part 3b.
[61] Data provided by *Insightia* (2022).
[62] *Ibid*.
[63] *Activist Short Selling Update, supra* note 4 at Part 3b.

group, while in the U.S. this comprises data from the NASDAQ and NYSE.[64] This comparison proves problematic, then, as the number of campaigns/issuers targeted by campaigns as cited by Insightia encompasses a broader range of exchanges.[65] Of the 52 campaigns launched against U.S. issuers, for instance, two were listed on OTC exchanges – which are not covered by the WFE dataset.[66]

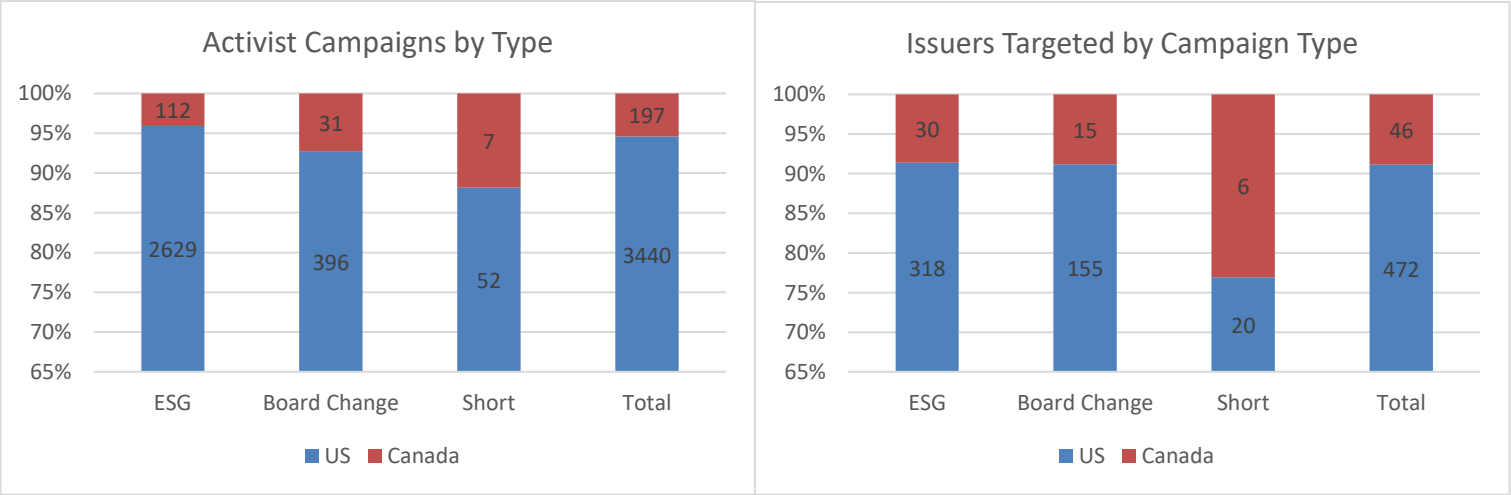
From the start of the year to October 7, 2022, the total number of activist campaigns launched and the number of issuers targeted, organized by campaign type, are as follows:[67]

Figure 1 – Number of Campaigns Launched and Number of Issuers Targeted by Campaign, by Type, in the US and Canada, From January 1 to October 7, 2022

	Number of Campaigns Launched		Number of Issuers Targeted	
	U.S.	**Canada**	**U.S.**	**Canada**
ESG	2629	112	318	30
Board Change	396	31	155	15
Short	52	7	20	6
Total[68]	3440	197	472	46

According to the CSA, the ratio of Canadian targets of short seller campaigns to U.S. targets over this time period is 7 to 50, or about 1:7.[69] In reality, this ratio is closer to 1:3.[70] As the data demonstrates, short selling campaigns disproportionately impact Canadian issuers when compared to activist campaigns of other types and as compared to total activism, whether as a measure of campaigns launched or issuers targeted by campaigns.

Figure 2 – Relative Percentages of Activist Campaigns and Issuer Targets, by Type, in the US and Canada, From January 1 to October 7, 2022



[68] Calculated across all campaign types.
[69] *Activist Short Selling Update, supra* note 4 at Part 3b.
[70] As demonstrated by Figure 1, data from Insightia reflects a ratio of 6 Canadian targets of short campaigns compared to 20 U.S. targets of short campaigns.

We have no doubt that the CSA published this data to illustrate that activist short selling campaigns were more prevalent in the U.S. than in Canada. Although a direct comparison of the data points to the opposite conclusion, we do not believe that this alone should be determinative of whether the regulations impacting short selling in Canada should be enhanced. For us, the key unanswered question remains, "Why should the short selling regulations in Canada be less stringent than in Europe, Australia or the U.S.?" To date, we do not believe the CSA or IIROC has answered this question adequately.

Response to CSA Request for Comments:

1. **Should the existing regulatory regime around pre-borrowing in certain circumstances be strengthened? What requirements would be appropriate? Specifically, should there be "pre-borrow" requirements similar to those in the U.S., as described above? Please provide supporting rationale and data.**

   We do not believe the existing regulatory regime around pre-borrowing is sufficient to address the systemic risks and other challenges associated with short selling. Moreover, Canada's pre-borrow requirements are less stringent compared to the European Union (the "**EU**") and the U.S. – which highlights how our regulations are not aligned with well-established financial markets. In order to improve investor confidence and market efficiency while appropriately reducing systemic risk, we recommend making revisions to UMIR to impose positive locate or pre-borrow requirements with respect to all short sales, subject to certain limited exceptions.[71]

   The Ontario Capital Markets Modernization Taskforce (the "**Modernization Taskforce**"), in its January 2021 final report (the "**Final Report**"), noted that the current requirements for short selling under UMIR "are not stringent enough to ensure that short sellers are taking appropriate steps to confirm that adequate securities are available to them to settle any short sale execution prior to entry of the order in the marketplace".[72] The Modernization Taskforce also recognized that the Ontario short selling regime stands in contrast to both the U.S. and the EU, which impose pre-borrow or locate requirements for short sales, and which impose or have plans to impose mandatory close-out or buy-in provisions.[73]

[71] *2019 Short Selling Paper, supra* note 5 at Section 8.6.
[72] Capital Markets Modernization Taskforce, *Final Report* at Section 25 (January 2021), online: *Government of Ontario* <https://files.ontario.ca/books/mof-capital-markets-modernization-taskforce-final-report-en-2021-01-22-v2.pdf>. [*Modernization Taskforce Final Report*].
[73] *Ibid*.

Recognizing the vulnerability of our regime to abusive short selling, the Modernization Taskforce recommended that IIROC revise UMIR to require an investment dealer to confirm the ability to borrow securities prior to accepting a short sale order.[74] Moreover, the Final Report provided a list of different types of confirmation, which included:

(i) confirmation that the security has been borrowed;

(ii) confirmation that a bona-fide arrangement has been made to borrow the security; or

(iii) confirmation that there are reasonable grounds to believe that the security can be borrowed (identified as "easy to borrow"), so that it can be delivered on the settlement date.[75]

Following the recommendation of the Modernization Taskforce in its Final Report, IIROC issued the Guidance,[76] which provided some additional clarity with respect to the requirement under UMIR that a Participant has a reasonable expectation that sufficient securities will be available to cover the settlement of a short sale trade prior to entering a short sale order.[77] Particularly, the Guidance imposed a higher standard, requiring that the vendor have "reasonable certainty" that it can access sufficient securities to settle the trade, and that a vendor must not enter a short sale order if it "knows or ought reasonably to know" that sufficient securities will not be available for settlement.[78]

Notwithstanding this new, higher standard articulated by IIROC in the Guidance, as explained further below, Canada remains out of step with comparable international jurisdictions with respect to our existing regulatory regime around pre-borrowing and "reasonable expectations" standards.

In the U.S., Regulation SHO requires that prior to effecting a short sale, broker-dealers must have either borrowed or entered into an arrangement to borrow the security, or have reasonable grounds to believe the security can be borrowed in time for delivery on the settlement date, known as a "locate" requirement.[79] This "locate" requirement

---

[74] *Ibid*.
[75] *Modernization Taskforce Final Report, supra* note 72 at Section 25.
[76] *The Guidance, supra* note 18.
[77] As confirmed in The Guidance, *supra* note 18 at (2), entry of a short sale order without a reasonable expectation of obtaining access to securities to settle any resulting trade on the settlement date, is prohibited by UMIR 2.2 – Manipulative and Deceptive Activities.
[78] *The Guidance, supra* note 18 at (2).
[79] *Short Sales: Proposed Rule*, SEC Release No. 34-48709 (28 October 2003) at § 242.203(b), online: *U.S. Securities and Exchange Commission* <www.sec.gov/rules/proposed/34-48709.htm> as adopted in Securities and

must be also be documented by the broker-dealer.[80] The rules provide for some limited exceptions, including for short sales effected in connection with bona-fide market making.[81]

The U.S. Securities & Exchange Commission noted that "Easy to Borrow" lists may provide "reasonable grounds" for a broker-dealer to believe that the security sold short is available for borrowing without directly contacting the source of the borrowed security.[82] In order for it to be reasonable that a broker-dealer rely on such lists, the information used to generate the "Easy to Borrow" list must be less than 24 hours old, and the securities on the list must be readily available such that it would be unlikely that a failure to deliver would occur.[83] Absent adequately documented mitigating circumstances, repeated failures to deliver in securities on an "Easy to Borrow" list would indicate that the broker-dealer's reliance on such a list does not meet the "reasonable grounds" standard.[84]

The EU goes even further than the U.S. requirements through the application of its Short Selling Regulations ("**SSR**") and complementary regulations.[85] Under Article 12 of the SSR, in order to engage in the short selling of a publicly traded security, a person must either:

(i) borrow the shares or make alternate provisions with a similar legal effect;

(ii) have an agreement to borrow the share or a legally enforceable claim to be transferred ownership of the securities to ensure settlement on the settlement date; or

---

Exchange Commission Release No. 34-50103 (2 August 2004) at Section V, online: *U.S. Securities and Exchange Commission* <https://www.sec.gov/rules/final/34-50103.htm#V> [*SEC Release No. 34-48709*].

[80] *Key Points About Regulation SHO* (31 May 2022) at Section III, online: *U.S. Securities and Exchange Commission* <https://www.sec.gov/investor/pubs/regsho.htm#:~:text=Regulation%20SHO%20requires%20a%20broker,to%20effecting%20the%20short%20sale.> [*Key Points About Regulation SHO*].

[81] *SEC Release No. 34-48709, supra* note 79 at Section V.

[82] *Ibid*.

[83] *Ibid*.

[84] *Ibid*.

[85] Regulation (EU) No 236/2012 of 23 March 2012 [*SSR*]. See also Commission Implementing Regulation (EU) 827/2012 of 29 June 2012 at Articles 5 and 6, online (pdf): *EUR-Lex* <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32012R0827&from=EN> [*Regulation 827/2012*]; Delegated Regulation (EU) 2018/1229 of 25 May 2018 at Articles 13-27, online (pdf): *EUR-Lex* <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32018R1229&from=EN>; and Regulation (EU) No 909/2014 of 23 July 2014, online (pdf): *EUR-Lex* <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:02014R0909-20220622&from=EN> [*CSDR*].

(iii) have an arrangement with a third party where they have a reasonable expectation of being able to settle the transaction on the settlement date (this is the EU's "locate" rule, set out in Article 12(1)(c)).[86]

Article 6 of *Commission Implementing Regulation 827/2012* ("**Regulation 827/2012**") details the different arrangements that a person must have with the third party in order to have a reasonable expectation of being able to settle the transaction on the settlement date.[87] These are as follows:

(i) for locate confirmations, the third party confirms that they have located the shares to be sold, taking into account the amount of the possible sale and market conditions and the third party confirms, prior to the short sale being entered into, that it has at least put on hold the requested number of shares. This is the "standard" functioning of the locate rule;[88]

(ii) where short selling is to take place on the same day, the short seller must first inform the broker that this is their intention. The third party must then confirm that it can make the shares available for settlement in due time, taking into consideration the amount of the possible sale and market conditions. The broker must then also confirm in the case of easy to borrow shares or purchase confirmations, that the share is easy to borrow or purchase, or, in the absence of such confirmation, that the third party has at least put on hold the requested number of shares. The short seller must monitor the market, and if he finds that he risks not being able to deliver, the short seller must then give an instruction to the third party to buy the shares needed to cover the short sale;[89] and

(iii) in the case of liquid shares,[90] for locate confirmations, the third party must provide a confirmation prior to the short sale being entered into that it considers that it can make the shares available for settlement in due time, taking into account the amount of the possible sale and market conditions. For easy to borrow shares or purchase confirmations, the third party must also confirm that the shares are easy to borrow or purchase in the required amount, or that the third party has at least put them on hold. When executed short sales will not be covered by purchases or borrowing, the short seller must provide an undertaking that prompt instruction will be sent to the third party instructing

[86] *SSR, supra* note 85 at Article 12(1)(a)-(c).
[87] *Regulation 827/2012, supra* note 85 at Article 6.
[88] *Regulation 827/2012, supra* note 85 at Article 6(2)(a).
[89] *Ibid* at Article 6(3)(a)-(e).
[90] "Liquid shares" refers to easy to borrow or purchase arrangements and measures as described in Article 6(4) of Regulation 827/2012*, supra* note 85. These refer to arrangements, confirmations and measures when the shares involved in the short sale meet the liquidity requirements in Article 22 of Commission Regulation (EC) No 1287/2006 or when shares are included in the main national equity index (identified by the relevant authority of each Member State), and are underlying derivative contracts admitting to trading on a trading venue with the elements identified at subsequent footnote.

them to procure the shares to cover the short sale to ensure settlement in due time.[91]

Article 6 of Regulation 827/2012 also requires that all of the above arrangements, confirmations and instructions must be provided in a durable medium by the third party to the person as evidence of such arrangements, confirmations and instructions.[92]

In *Consultation Paper: Review of certain aspects of the Short Selling Regulation*, the European Securities and Markets Authority (the "**ESMA**") proposed changes to Article 12(1)(c) of the SSR in order to enhance the legal certainty of third party arrangements for short selling.[93] The ESMA noted that under the current rules, third parties need not provide firm commitments to make the shares available as necessary.[94] Additionally, the ESMA noted that the locate confirmations required for all types of locate arrangements were dependent on the prevailing market conditions at the time the confirmations were provided, and that as a result, a third party with an obligation to deliver shares under a locate confirmation could argue that the market conditions have changed before the settlement date to avoid delivery.[95]

As a result of these perceived weaknesses in the locate arrangement requirements, the ESMA recommended creating one uniform locate arrangement that would be composed of two requirements:[96]

(i) a confirmation provided by the third party prior to the short sale being entered into, stating that it firmly commits to make the shares available for settlement in due time, taking into account the amount of the possible sale, and which indicates the period for which the shares are located; and

(ii) an undertaking from the natural or legal person that in the event that executed short sales will not be covered on the settlement date, the natural or legal person will promptly send an instruction to the third party to procure the shares to cover the short sale to ensure settlement in due time.

Despite the shortcomings recognized by the ESMA of the current locate arrangements under the SSR, the ESMA ultimately did not recommend amending Article 12(1)(c) of

[91] *Regulation 827/2012, supra* note 85 at Article 6(4)(a)-(c).
[92] *Ibid* at Article 6(5).
[93] *Consultation Paper: review of certain aspects of the short selling regulation* (21 September 2021) at para 187, online (pdf): *European Securities and Markets Authority* <https://www.esma.europa.eu/sites/default/files/library/esma70-156-3914_consultation_paper_on_the_review_of_certain_aspects_of_the_short_selling_regulation.pdf.
[94] *Ibid* at para 186(a).
[95] *Ibid* at para 186(d).
[96] *Ibid* at paras 189-190(d).

the SSR based on the concerns expressed by commenters.[97] Commenters noted that such a revision to the locate arrangements would amount to a restriction on short selling that would damage market liquidity, as short selling is essential for other market activities such as market making or hedging long positions.[98] Commenters also noted a lack of evidence supporting the need for the proposed tightening of the locate requirements under the SSR.[99] Certain commenters were also of the view that the risk of non-delivery of the relevant shares on the settlement date would be adequately addressed by settlement discipline measures imposed under Central Securities Depositories Regulation ("**CSDR**").[100]

Notwithstanding that the SSR already imposed an obligation to document compliance with Article 12(1)(c), the ESMA recommended that Article 12 should contain an explicit requirement that natural and legal persons entering a short sale keep records of their "locate" arrangements for five years.[101] In doing so, the ESMA stated that it recognized that the "lack of an explicit requirement in Level 1 to record and store all the documentation regarding the requirements set out in Article 12 of SSR may seriously undermine the capacity of Relevant Competent Authorities ("**RCAs**") to monitor their effective fulfilment with the subsequent risk for the integrity and orderliness of the market. Those records become even more relevant in a situation where most RCAs monitor breaches of Article 12 of SSR on an ex-post basis, mostly where a settlement failure has taken place".[102] Clearly, the ESMA and EU market participants view the documentation of compliance with rules as a key part of enforcement.

---

[97] *Final Report: Review of certain aspects of the Short Selling Regulation* (22 March 2022) at para 226, online (pdf): *European Securities and Market Authority* <https://www.esma.europa.eu/sites/default/files/library/esma70-448-10_final_report_-_short_selling_regulation_review.pdf> [*ESMA Final Report*].

[98] *Ibid* at para 221(a).

[99] *Ibid* at para 221(b).

[100] Regulation (EU) No 909/2014 was originally introduced in 2014 with the aim of harmonizing certain aspects of the settlement cycle and settlement discipline by providing a set of common requirements for central securities depositories ("CSDs") operating securities settlement systems across the EU (*CSDR, supra* note 85 at Recital 5). The CSDR Settlement Discipline Regime ("SDR") will require firms to put in place settlement discipline measures to prevent and address settlement fails (*CSDR, supra* note 85 at Recitals 13 and 14). The SDR imposes three main measures to address settlement fails: the reporting of settlement fails, the application of cash penalties and a mandatory buy-in regime. The cash penalties went live on February 1, 2022, while the proposed mandatory buy-in provisions have been suspended until 2025 pending further revision (*Final Report: CSDR RTS on Settlement Discipline – Suspension of buy-in* (2 June 2022) at Section 2.1, para 1, online (pdf): <https://www.esma.europa.eu/sites/default/files/library/esma70-156-5011_final_report_-_rts_settlement_discipline_-_buy-in_suspension.pdf> [*ESMA Final Report – Suspension of Buy-In*]) The new cash penalties regime coupled with the incoming mandatory buy-in regime is intended to serve as an effective deterrent for market participants that cause settlement fails and to incentivize those in the settlement chain to settle trades in a timely manner (*CSDR, supra* note 85 at Article 7(2)). Various commenters noted the deterrent effect of the CSDR including, Association Francaise des marches financiers (AMAFI), Bundesverband der Werlpapierfirmen, the Association for Financial Markets in Europe (AFME) and the International Swaps and Derivatives Association (ISDA), the International Securities Lending Association (ISLA) and Société Générale. For further discussion of the CSDR, please refer to question 8, contained herein.

[101] *ESMA Final Report, supra* note 97 at paras 229, 233.

[102] *Ibid* at para 231.

From the above, it is clear that Canada is out of step with other jurisdictions with respect to "locate" requirements. In the U.S., for a broker-dealer to have "reasonable grounds", a broker-dealer must either directly contact the source of the borrowed securities, or alternatively, rely on "Easy to Borrow" lists provided certain criteria (as discussed above) are met.[103] Additionally, and in every case, a broker-dealer must document its compliance with the "reasonable grounds" requirement.[104] In the EU, the "reasonable expectation" standard also requires that (no matter the type of "locate" arrangement), the short seller obtain confirmation from a third party that it has located the shares, and confirmation from the third party that either the shares are either easy to borrow or purchase, or that the third party has put the shares on hold.[105]

In Canada, IIROC's Guidance (which we note is not equivalent to a legal requirement or rule) provides only that prior to entering into a short sale, a Participant must have "reasonable certainty" that it can access sufficient securities for it to settle any trade on the settlement date, and that if the Participant knows or ought reasonably to know that it is unlikely sufficient securities will be available to deliver on the settlement date, the order cannot be entered.[106] The issue then, is what actions must be taken for a Participant to have such "reasonable certainty"? Is the requirement similar to that of the U.S. or the EU, where there must be some kind of confirmation obtained by the Participant that the shares can be borrowed to effect settlement? Alternatively, is it enough that shares are generally liquid, or that the client on behalf of which the Participant will be entering the short sale order has not, in the past, failed to make delivery to meet the "reasonable certainty" requirement?

These questions highlight the continued vagueness of IIROC's "reasonable expectation" rule. This stands in contrast to the U.S. and EU, both of which also have similar "reasonable expectations" concepts, but outline more concrete criteria for meeting this standard. IIROC has taken one ambiguous term – "reasonable expectation" – and attempted to clarify it with another, equally ambiguous term, "reasonable certainty". In addition, Canada is clearly out of step with other jurisdictions in its lack of a requirement to document compliance with having met the "reasonable expectation" standard prior to effecting a short sale.

IIROC has to date not provided any compelling rationale for its continued deviation from "locate" measures imposed in comparable jurisdictions. This is notwithstanding that the Modernization Taskforce in its Final Report recognized that the "current requirements under IIROC's [UMIR] are not stringent enough to ensure that short

[103] *SEC Release No. 34-48709, supra* note 79 at Section V.
[104] *Key Points About Regulation SHO, supra* note 80 at Section III.
[105] *SSR, supra* note 85 at Article 12(1)(c).
[106] *The Guidance, supra* note 18 at (2).

sellers are taking appropriate steps to **confirm** that adequate securities are available to them to settle any short sale execution prior to the entry of an order in the marketplace".[107] [emphasis added] Even with IIROC's Guidance released following the Final Report and as discussed above, it is unclear whether a Participant is required to obtain any kind of confirmation prior to entering into an order for a short sale. The lack of insistence on "confirmation" that the trade can be settled is even more concerning considering the data from the 2022 Failed Trade Study, noting that there are settlement issues with certain securities exchanges and short sales have an impact on failed trades.[108]

In the absence of a clear and cogent justification by IIROC for the misalignment of its "reasonable expectation" standard with other jurisdictions, we believe that either U.S. or EU-style locate requirements should be in place in Canada, with a corresponding requirement to document compliance with such requirements.

2. What would be the costs and benefits of implementing such requirements?

As previously explained, the main benefit of implementing positive locate or pre-borrow requirements for all short trades would be to improve investor confidence and market efficiency while appropriately reducing the systemic risk associated with short selling. We would also expect that it would directly reduce the risk of naked short selling.

We understand that the implementation of positive locate or pre-borrow requirements may pose difficulties in Canadian junior markets – that is, the securities of venture issuers – which tend to have lower liquidity and higher volatility. However, we note that such issues also exist in other comparable markets, such as Australia, which have followed IOSCO Principle 1.[109] In any event, we recognize that a detailed cost-benefit analysis would need to be undertaken by IIROC and Participants in order to make a fully-informed decision as to the precise costs and benefits of any locate or pre-borrow requirements which may be imposed.

In this regard, we should also note that in discussions with our clients and large institutions who have engaged with us in their efforts to respond to the Staff Notice, they all indicate that, at a minimum, they already comply with the U.S. locate requirements. If the vast majority of the market already meets this standard, then we would expect that the cost of adoption would be negligible, but this also raises the issue of why IIROC continues to struggle with adopting rules similar to those in the U.S. or Europe.

[107] *Modernization Taskforce Final Report, supra* note 72 at Section 25.
[108] As demonstrated with the data presented in Section 4(A) of the 2022 Failed Trade Study, *supra* note 3.
[109] *2019 Short Selling Paper, supra* note 5 at Section 8.3.

3. Does the current definition of a "failed trade", as described in Part 1 of the Staff Notice, appropriately describe a failed trade?

We have no concerns with the definition of a "failed trade" as described in Part 1 of the Staff Notice, or with the definition of "failed trade" in UMIR rule 1.1.

4. Should a timeline shorter than ten days following the expected settlement date be considered? What would be an appropriate timeline? Please provide rationale and supporting data.

The trigger date to file an EFTR is of importance in the current regulatory regime for three reasons:

(i) the basis of the automatic imposition of pre-borrowing obligations;

(ii) reporting requirements by Participants and Access Persons; and

(iii) reporting requirements after the submission of an EFTR to explain how the failed trade ultimately settled.[110]

The imposition of pre-borrow obligations after an EFT has occurred is a reflection of IIROC's belief that pre-borrow obligations should only be imposed as a reactive measure of last resort.[111] We believe that to address systemic risk in a meaningful manner that protects investors and our capital markets, regulations must be proactive.

As first outlined in our 2019 Short Selling Paper, we believe that the requirement to file an EFTR only after ten days following the expected settlement date is neither reasonable or in the public interest,[112] for two reasons. First, as it is the filing of an EFTR which serves as the basis for the automatic imposition of pre-borrow obligations, ten days is an unacceptably lengthy period of time for a reactive response to short selling.[113] Failed trades as a result of naked short sales can be rectified well before the ten day period.[114] Second, it is only when an EFTR is filed that a reason for the failure to deliver must be provided to IIROC. As a result, there is a "blind spot" as to reported reasons for settlement failure for failed trades prior to ten days after the settlement date. This lack of transparency makes policy making with respect to failed trade and short sale regulation difficult.

The ten-day trigger date for the filing of EFTRs was implemented by IIROC on the premise that failed trades were mainly due to "administrative errors" and that a ten-day period would allow time for such failed trades to be rectified.[115] The foundation for this premise was, at least in part, IIROC's 2007 Failed Trade Study, which found that 51% of failed trades reported under that study were due to "administrative errors".[116]

---

[110] *Ibid* at Section 7.5.
[111] *Ibid.*
[112] *2019 Short Selling Paper, supra* note 5 at Section 7.5.
[113] *Ibid* at Section 3.2.6.3.2.
[114] *Ibid* at Section 8.4.
[115] *Ibid* at Section 3.2.4.1.5. See also discussion of the 2012 Proposed Amendments at *2019 Short Selling Paper, supra* note 5 at Section 3.2.6 as IIROC continues to monitor and review the occurrence and frequency of failed trades and whether it is accurate to say that most are explained by administrative errors.
[116] *2007 Failed Trade Study, supra* note 24 at 6.

We have discussed at length in our paper the significant issues with the 2007 Failed Trade Study, and the CSA has itself recognized in the Activist Short Selling Update that the 2007 Failed Trade Study was conducted "using limited data".[117] We reiterate our surprise that such a limited study formed the basis for concrete policy decisions, including both the trigger date for EFTRs and the apparent inappropriateness of "hard" close-out provisions in Canada.[118]

The 2022 Failed Trade Study does not provide any data with respect to the reasons for trades which failed prior to ten days after the expected settlement date, presumably because reasons for failed trades are only provided with the filing of an EFTR. Therefore, there is no comparable data in the 2022 Failed Trade Study to that in the 2007 Failed Trade Study with respect to the reasons for failed trades prior to ten days after the expected settlement date. This highlights the problems with the current failed trade reporting regime in Canada in that the EFTR reporting requirements, which are the only source of information for IIROC outlining *reasons* for failed trades, only provides such information, based on the 2022 Failed Trade Study, for a small portion of failed trades.[119] In any event, the 2022 Failed Trade Study EFTR data also suggests that a third of failed trades (33%) for CNS EFTRs are because of short selling, and that more than a third (37%) of all TFT EFTRs fail because of short selling.[120] This is in contrast to the 2007 Failed Trade Study, which found that only 6% of fails were a result of short selling.[121] This may suggest either that IIROC's assessment was correct and that *most* fails are as a result of administrative error, settle prior to the ten days, and leave a larger proportion of failed trades that fail as a result of short selling outstanding, or, alternatively, that short sales in fact do account for a larger proportion of failed trades than the 2007 Failed Trade Study originally suggested. We ultimately do not know the answer to this question because the 2022 Failed Trade Study only provided information with respect to reasons for EFTs. As a result, a key basis for the ten day trigger for the filing of EFTRs cannot be confirmed.

Ultimately, it is difficult to suggest an appropriate trigger date for the filing of an EFTR without a proper empirical basis. For example, if the average failed trade took four trading days to settle after the expected settlement date, and the predominant reason for failed trades during this time period was administrative error, then it might be justifiable to set the trigger date at five trading days after expected settlement, to capture those trades which remain unsettled for an "above average" period of time. As EFTRs also serve an important data-gathering function, a shorter time period would also be prudent to provide IIROC with more information as to the reasons underlying failed trades, in order to re-evaluate policy decisions with an adequate factual foundation. Given that, based on the 2022 Failed Trade Study, approximately 93% of TFT failed trade volume settled five days after settlement, a five day trigger for EFTRs may be more appropriate, as this would still exclude a significant number of failed trades which may be outstanding as a result of administrative delays, but significantly

[117] *Activist Short Selling Update, supra* note 4 at Part 3a.
[118] *2019 Short Selling Paper, supra* note 5 at Section 7.4.1.
[119] *The 2007 Failed Trade Study, supra* note 24 at 6 found that approximately 88 percent of trades had settled within 5 days, with 98 percent settling within 15 days.
[120] *2022 Failed Trade Study, supra* note 3 at 4.
[121] *2007 Failed Trade Study, supra* note 24 at 6.

reduce the trigger date for the filing of EFTRs. However, as noted above, this data may not be representative of failed trades more broadly, and as a result, we feel that further data collection is required in order to make a proper determination as to the appropriate trigger dates for EFTRs.

We also note that at the time of implementation of the EFTR requirement, the settlement cycle was T+3, and subsequently moved to T+2.[122] The settlement cycle in Canada will be moving to T+1 in 2024 in line with the U.S.[123] We believe that the further shortening of the settlement cycle is an additional reason to shorten the EFTR trigger date.

With respect to any burden that a shortening of the EFTR trigger date might impose on Participants and Access Persons, we have no doubt that there will be additional costs of compliance with a shortened trigger date. We do believe that such additional costs must be considered. However, such costs will have to be considered in light of the impact of other changes, including if a general pre-borrow or locate requirement were imposed by IIROC (as we are in favour of, and as discussed above in response to Question 1). Additionally, assuming that the 2022 Failed Trade Study data with respect to TFT failed trade volume settlement is representative of failed trades more broadly, a shortened EFTR trigger date of five days would likely not impose a significant burden on market participants as this would capture only approximately 5% more of failed trade volume.

5. Should additional public transparency requirements of short selling activities or short positions be considered? Please indicate what such requirements should be and the frequency of any disclosure. Please also provide a rationale and empirical data to support your suggestions or to support why changes are not needed.

We have extensively discussed the issues surrounding short selling transparency in Canada (and lack thereof) in our 2019 Short Selling Paper and our 2021 Comment Letter.[124] Our response will focus on the need for disclosure of failed trades data, why we do not believe that individual (non-anonymous) public disclosure of short positions is warranted, and the importance of increased frequency of disclosure.

Disclosure of Failed Trades Data

Currently, IIROC still does not publish failed trade data, despite calls for public disclosure of this type of data as early as 2013.[125] As noted in our 2019 Short Selling Paper and our 2021 Comment Letter, the lack of disclosure in the Canadian regulatory

[122] CSA Staff Notice 24-318: *Preparing for the Implementation of T+1 Settlement* (3 February 2022) at 1, online (pdf): *Ontario Securities Commission* <https://www.osc.ca/sites/default/files/2022-02/csa_20220203_24-318_preparing-implementation-settlement.pdf> [*Staff Notice 24-318*].
[123] *Ibid* at 1.
[124] *2021 Comment Letter, supra* note 6. See also 2019 Short Selling Paper, *supra* note 5.
[125] *2019 Short Selling Paper, supra* note 5 at Section 7.2.2.

landscape is inconsistent with that of other comparable jurisdictions—failed trade data is disclosed in both the U.S. and Australia, and more recently, in the EU, pursuant to the CSDR, which went into effect in February 2022 and requires settlement fails reports to be reported daily and published annually.[126]

This deviation from other regimes has never been adequately explained. Previously, IIROC has justified the lack of public disclosure of failed trade data as due to failed trades comprising only a small percentage of overall trades conducted on Canadian marketplaces, comprising just 0.27% of all trades executed (based on the 2007 Failed Trade Study).[127] However, notwithstanding this finding, we note that the 2022 Failed Trade Study suggests that as a percentage of total traded *volume*, CNS failure ranges from approximately 3% to 19%, depending on the exchange.[128] In light of this data, IIROC should reconsider disclosure of failed trades. Moreover, in the IIROC/CSA Joint Notice 23-312: *Request for Comments – Transparency of Short Selling and Failed Trades*,[129] IIROC sought comments as to whether the disclosure of failed trade data was warranted and noted that:

> Reporting [failed trade] rates would provide a means of comparing information on short positions and short selling with trade failures during the same period, therefore allowing the reader to determine whether rates of trade failure may be correlated with rates of short selling of a particular security.

More recently, in the 2022 Failed Trade Study, IIROC acknowledges that failed trades may be an issue, particularly for junior securities and certain types of dealers.[130] The study also concludes that "short selling is a factor in many extended failed trades reports".[131] Disclosing failed trades is an important measure to prevent settlement fails by informing the market about which securities are scarce. As noted above, it is also clear that, in contrast to the findings of the 2007 Failed Trade Study, the 2022 Failed Trade Study shows that the volume of shares which fail to settle is not immaterial, particularly depending on the exchange.[132] Therefore, the publication of failed trade data may be more imperative than ever. The current lack of disclosure does not enhance investor protection, inspire confidence in our capital markets, nor contribute to market efficiency.

---

[126] *Ibid*. See also *CSDR, supra* note 85 at Article 7(1).
[127] *2007 Failed Trade Study, supra* note 24 at 6, using data from Table 2. Note that the 2007 Failed Trade Study is only composed of data from the TSX, TSXV, and the CNQ (now the CSE).
[128] *2022 Failed Trade Study, supra* note 3 at Table 1.
[129] CSA/IIROC Joint Notice 23-312: *Request for Comments – Transparency of Short Selling and Failed Trades*, (2 March 2012) at 4, online (pdf): *Ontario Securities Commission* <https://www.osc.ca/sites/default/files/pdfs/irps/csa_20120302_23-312_rfc-trans-short-selling.pdf>.
[130] *2022 Failed Trade Study, supra* note 3 at 15.
[131] *Ibid*.
[132] *2022 Failed Trade Study, supra* note 3 at Table 1.

Individual Disclosure of Short Positions Not Warranted

As extensively covered in our 2019 Short Selling Paper and our 2021 Comment Letter, we do not believe that the disclosure of short positions by individual persons is consistent with the policy rationale underlying the disclosure of security positions in our securities regulatory regime.[133] We also do not believe that disclosing the identity of individual investors is necessary to advance the policy goal of increasing public transparency into short selling activity. Furthermore, we are concerned that such disclosure would have a "chilling effect" and may therefore significantly impact liquidity. Moreover, it would shift the burden of reporting obligations on short selling activity in Canada from Participants and Access Persons to their clients, which would no doubt impose a significant cost on investors.

Accordingly, we do not see a basis for recommending the disclosure of short positions on an individual basis from a policy or public interest perspective.

Timing of Disclosure

We suggest that proper transparency can only be achieved through timely disclosure. For example, the benefits of price discovery and deterring attempts at market abuse are assisted with timely disclosure. Presently, IIROC makes information on aggregate short positions on a by-issuer basis available twice monthly in Canada, but such a delay is not optimal.[134] This data shows the actual number, value, and volume of short sales of each listed security and as a percentage of total trading activity for that security.[135] The Financial Industry Regulatory Authority ("**FINRA**") in the U.S. publishes similar short sale trade data; however, the available information regarding aggregated short sale volume by security is limited to off-exchange trades (i.e. OTC), although FINRA does provide short interest information of exchange-listed securities to the applicable listing exchange, which may choose to publish the data.[136]

We acknowledge that much of the disclosure on short selling in various jurisdictions does not occur daily. In the U.S., for instance, FINRA members are currently required to submit short interest reports to FINRA twice a month. Once received, the short interest data is compiled for each security and published on the seventh business day after the reporting settlement date.[137] However, in 2021, FINRA indicated it was

[133] *2021 Comment Letter, supra* note 6; See also *2019 Short Selling Paper, supra* note 5.
[134] As explained in the *2021 Comment Letter, supra* note 6 at 9.
[135] *Short Sale Trading Statistics and Reports*, online: *Investment Industry Regulatory Organization of Canada* <https://www.iiroc.ca/sections/markets/reports-statistics-and-other-information/short-sale-trading-statistics-and-reports>.
[136] Regulatory Notice 21-19: *FINRA Requests Comment on Short Interest Position Reporting Enhancements and Other Changes Related to Short Sale Reporting* (4 June 2021) at 3, online (pdf): *Financial Industry Regulatory Authority* <https://www.finra.org/sites/default/files/2021-06/Regulatory-Notice-21-19.pdf>.
[137] *Ibid* at 5.

considering a reduction in the reporting timeframe to daily or weekly submissions, rationalizing that more frequent disclosure would "provide FINRA, other regulators, investors and other market participants with a more current view of short interest information, better inform investors' and other market participants' investment decisions, and provide more timely information to FINRA for regulatory use."[138] FINRA also considered reducing the processing time involved in disseminating short interest data, which would allow a timelier release of short interest data to the public—this could apply to both the proposed daily or weekly reports, or the current twice a month reporting cycle.[139]

Most data, particularly with respect to short sale volume and failed trades, are collected daily, including in Canada. Therefore, we would expect that the cost of providing daily disclosure, particularly where such information is already available, such as failed trades and short trades, would be minimal, particularly when measured against the benefits of a better informed securities market.[140]

Further, it is difficult to understand how the disclosure of short selling information could negatively affect price discovery, to the point of adversely impacting liquidity, rational capital allocation and the other benefits of proper price discovery. If there is disclosure of aggregated short selling and failed delivery information, there is perhaps some risk that issuers and other market participants will take steps against short sellers. However, it is not clear why short sellers should be treated so differently than other sellers or purchasers of shares. Aggregate long data is readily available on a moment-by-moment basis and, absent clear policy reasons, we do not accept that short selling information should be treated differently. Securities laws are premised on the merits of transparency and we see no reason why that should apply almost exclusively to the long side of the market.[141]

We submit that abusive short selling has potential to inflict harm on the markets and perhaps even the economy, and timely transparency appears to be a logical and constructive means to limit such potential and enhance the benefits of short selling. We therefore recommend daily disclosure of aggregate short positions, short trading and failed trades.

Finally on this point, the concern regarding abusive short selling is becoming more prevalent and is clearly impacting confidence in the capital markets – particularly among junior issuers and their investors.[142] We have no doubt that greater

[138] *Ibid* at 5.
[139] *Ibid* at 5.
[140] *2021 Comment Letter, supra* note 6 at 9.
[141] *Ibid* at 9-10.
[142] "*Small-cap companies are going after naked short sellers in growing numbers*" (24 January 2023), online: *MarketWatch* <https://www.marketwatch.com/story/small-cap-companies-are-going-after-naked-short-sellers-in-

transparency is critical to addressing this concern and would restore greater confidence in our markets. IIROC and other authorities claim to have significant information regarding short sales and trade failure rates (generally through EFTRs and information provided by CDS)[143] Disclosing such information would be helpful in this respect and may also allow market participants to better address the questions raised in the Staff Notice.

6. **Should additional reporting requirements regarding short selling activities be considered by the securities regulatory authorities? Please indicate what such requirements should be and the frequency of any disclosure. Please also provide a rationale and empirical data to support your suggestions or to support why changes are not needed.**

   We recognize that there have been developments in other jurisdictions regarding reporting requirements with respect to short selling activities.[144] Nevertheless, we would suggest that the other recommendations suggested in this letter be advanced first before considering additional regulatory changes.

7. **As noted above, IIROC's study of failed trades showed that correlations between short sales and settlement issues in junior securities were more significant, and that junior securities experience more settlement issues compared to other securities. Should specific reporting, transparency or other requirements be considered for junior issuers? Please provide additional relevant details to support your response.**

   We believe that more importantly, and in order to properly answer such a question, greater transparency is needed as to why junior issuers experience more settlement issues, and the causes of such issues. Without proper data or understanding of the issues and underlying causes, it is difficult (if not impossible) to provide policy prescriptions to rectify these issues. Any policy making decisions must be based on empirical evidence. To that end, we believe there must be a more detailed study conducted as to the reasons underlying why junior securities may experience more settlement issues, and why junior securities show a greater correlation between short sales and settlement issues, as based on the information in the 2022 Failed Trade Study.

   However, as a general principle and starting point, we do not believe that different regulations or requirements in connection with short selling should apply based on the type of issuer. Our focus has always been on addressing systemic risk within the Canadian regulatory regime. Presumably, if there are issues within the Canadian

growing-numbers-its-the-biggest-risk-to-the-health-of-todays-public-markets-11674480805>. See also the work of Save Canadian Mining and CEOBLOC.

[143] *Notice 12-0078, supra* note 29 at 1.6. See also *Material Amendments to CDS Procedures* (9 May 2013) at 13.3.1(B), online (pdf) *Ontario Securities Commission* <https://www.osc.ca/sites/default/files/2021-01/cds_20130509_rfc-amd-trade-confirmation.pdf>.

[144] Such as the U.S. and E.U., as previously discussed in this comment letter.

regulatory regime such that junior issuers experience settlement issues associated with short sales, then more mature issuers may also experience such issues in certain circumstances. We believe that Canadian regulations pertaining to short sales should be issuer agnostic and ensure that the regulatory regime appropriately protects against abusive short selling in all circumstances, not just for select classes of issuers.

8. Would mandatory close-out or buy-in requirements similar to those in the U.S. and the European Union be beneficial for the Canadian capital markets? Please provide rationale and data substantiating the costs and benefits of such requirements on market participants.

We would recommend the implementation of mandatory close-out/buy-in procedures, with the caveat that effective locate or pre-borrow requirements may be sufficient instead of the imposition of compulsory buy-in procedures. As discussed above, in our 2019 Short Selling Paper, and in our 2021 Comment Letter, the Canadian regime stands out in contrast to both the U.S. and EU regimes, which impose pre-borrow or locate requirements for short sales and impose or have plans to impose mandatory close-out or buy-in provisions.[145] While Canada does have some measure of buy-in processes that occur after a failed trade, these are non-compulsory and not mandated by any rule or regulation—we see no reason why buy-ins cannot be made mandatory.

In Canada, UMIR does not impose buy-in requirements, but CDS and certain individual exchanges have optional buy-in processes that allow enforcement of the seller's settlement obligations for failed trades.[146] In contrast, in the U.S., brokers and dealers that are part of a registered clearing agency must close out by no later than T+3, pursuant to Regulation SHO.[147] If a position is not closed out, the broker or dealer may not effect further short sales in a security without borrowing or entering into a bona fide agreement to borrow the security. If a failed trade remains for 13 consecutive days, Regulation SHO requires participants of registered clearing agencies to immediately purchase securities to close out failed trades in "threshold securities" (securities with large and persistent failures to deliver).[148]

A similar regime has been established in the EU (but is not yet in force), where pursuant to the SSR, a central counterparty clearing house (CCP) that provides

---

[145] *2021 Comment Letter,* supra note 6 at 6.
[146] See *Trade and Settlement Procedures* (4 September 2018) at Chapter 8, online (pdf): *TMX CDS – The Canadian Depository for Securities Limited* <cds.ca/resource/en/67>. *Clearing and Settlement of Trades in Securities*, Toronto Stock Exchange Rulebook at Rule 5, online (pdf): *Toronto Stock Exchange* <https://www.tsx.com/resource/en/1464>. See also *Clearing and Settlement of Trades of Securities*, Toronto Stock Exchange Venture Exchange Rulebook at Rule C.3.00, online (pdf): *Toronto Stock Exchange* <https://www.tsx.com/resource/en/1465>. See also *2019 Short Selling Paper, supra* note 5 at Section 2.4.7.
[147] *Key Points About Regulation SHO, supra* note 80 at Rule 204.
[148] *Ibid*.

clearing services must ensure the presence of adequate buy-in procedures.[149] These procedures are automatically triggered if a seller is not able to deliver shares for settlement in four business days after the day on which settlement is due (T+6).[150] If a buy-in is not possible, the seller is required to pay the buyer an amount based on the value of the shares to be delivered, plus an amount for losses incurred by the buyer as a result of the settlement failure.[151] However, citing the difficulties faced by market participants regarding the implementation of the mandatory buy-in regime and in consideration of the time required for the CSDR review to thoroughly consider the mandatory buy-in framework as a part of settlement discipline, ESMA further published an amendment in June 2022 delaying the application of the buy-in regime to 2025.[152]

Although there are no specific buy-in procedures in Australia, the requirements to effect a short sale are stringent—a short seller must have, or believe on reasonable grounds to have, a "presently exercisable and unconditional right to vest the shares" in the buyer, which can be achieved by a securities lending arrangement, or any other legally binding commitment to deliver the securities before the settlement date.[153]

In the EU, CSDR also imposes cash penalties as a consequence for failed trades—cash penalties are calculated on a daily basis for each business day that a transaction fails to be settled after its intended settlement date (until the end of a buy-in process, if applicable) but no longer than the actual settlement day.[154] The level of cash penalties is closely related to the value of the financial instruments that failed to be delivered and ranges from 0.1 to 1 basis point, depending on the product type.[155] In Canada, CDS charges a daily fee of $1000 per day for failure to deliver shares to settle an outstanding settlement position in its CNS system but these fees carry no regulatory sanction.[156]

When viewed against this backdrop, Canada's regulations appear quite inadequate—not only does UMIR not impose general pre-borrow or locate requirements (although IIROC can impose specific pre-borrow requirements for specific securities), the optional buy-in process stands in direct contrast to the recommendation of the Modernization Taskforce to implement a buy-in requirement triggered at T+4.[157]

---

[149] SSR, *supra* note 85 at Article 15.
[150] *Ibid.*
[151] *Ibid.*
[152] ESMA Final Report – Suspension of Buy-In, *supra* note 100 at Section 2.2.
[153] *ASIC Regulatory Guide 196: Short Selling* (October 2018), online (pdf) at RG 196.22: *Australia Securities and Investment Commission* <https://download.asic.gov.au/media/4896780/rg196-published-8-october-2018.pdf>.
[154] CSDR, *supra* note 85 at Article 7(2).
[155] Commission Delegated Regulation (EU) 2017/389 (11 November 2016) at Annex, online (pdf): *EUR-Lex* <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017R0389>.
[156] *2023 Price Schedule* (Effective 1 January 2023), online (pdf): *Canadian Depository for Securities Limited* <https://www.cds.ca/resource/en/275/>.
[157] *Modernization Taskforce Final Report, supra* note 72 at Section 25.

> Moreover, we note that IIROC's decision not to impose compulsory buy-in requirements was based largely on the conclusion drawn from the 2007 Failed Trade Study that failed trades were not of predominant concern in Canada; as the most recent 2022 Failed Trade Study demonstrates, this conclusion was not borne out.[158] Additionally, IOSCO's 2009 Regulation of Short Selling report recommended that the "regulation of short selling should as a minimum requirement impose a strict settlement (such as compulsory buy-in) of failed trades";[159] 14 years later, this has yet to be achieved.

If you wish to discuss any aspect of this letter, we would encourage you to contact any one of the following lawyers who would be pleased to speak to you at your convenience:

Charlotte Conlin (charlotte.conlin@mcmillan.ca; 416-865-7239)

Paul Davis (paul.davis@mcmillan.ca; 416-307-4137)

Troy Hilson (troy.hilson@mcmillan.ca; 416-945-8021)

Shahen A. Mirakian (shahen.mirakian@mcmillan; 416-865-7238)

Leila Rafi (leila.rafi@mcmillan.ca; 416-945-8017)

Ouvedi Rama Naiken (ouvedi.ramanaiken@mcmillan.ca; 416-865-7042)

Anju Xing (anju.xing@mcmillan.com; 416-865-7212)

Sandra Zhao (sandra.zhao@mcmillan.ca; 416-865-7808)

[158] As shown in the data displayed in the 2022 Failed Trade Study, *supra* note 3 at Table 1 and Figure 3.
[159] *Regulation of Short Selling Consultation Report* (March 2009) at Section 3.7, online (pdf): *International Organization of Securities Commissions* <www.iosco.org/library/pubdocs/pdf/IOSCOPD289.pdf>.