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BY EMAIL

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and

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RE: Joint Canadian Securities Administrators and Investment Industry Regulatory Organization of Canada Staff Notice 23-329 - Short Selling in Canada

CNSX Markets Inc., operator of the Canadian Securities Exchange ("CSE"), thanks the Canadian Securities Administrators ("CSA") and the New SRO for the opportunity to provide feedback on CSA 23-329 – *Short Selling in Canada* ("23-329" or "Joint Notice"). Unless otherwise indicated, we have used the same defined terms as 23-329.

We would first like to commend the staff involved in the preparation of the Joint Notice for their careful analysis of short selling in Canada, including the detailed review of failed trades and responses to concerns raised by marketplace participants during previous short selling consultations. We recognize the complexity of the issues and appreciate the thoughtfulness that has gone into the questions posed in the Joint Notice. We would also like to express our appreciation for the work that went into conducting the Failed Trade Study ("FT Study") published by New SRO concurrently with the Joint Notice.

We provide our general comments below and respond to specific questions in Appendix A.

General Comments

CSE is currently home to nearly eight hundred issuers. Table 1 below provides a breakdown of the issuers by sector. Many of the issuers have been listed on the CSE for the entirety of their time as public companies, which has afforded our staff the opportunity to develop deep working relationships with their leadership groups. It is fair to say that concern over improper short selling behaviour in Canada's secondary markets is near universal among this community.

TABLE 1: CSE Issuers by Sector

Sector	# of Issuers
CleanTech	10
Diversified Industries	107
Life Sciences	198
Mining	316
Oil and Gas	13
Technology	136
Total	780

As noted in New SRO's timely FT Study, junior securities, such as those most commonly listed on the CSE, "generally have more settlement issues than senior securities. This includes a higher percentage of failed trades, longer times before trade-for-trade ("TFT") failed trades are settled, and stronger correlations between measures of short selling and measures of CNS settlement issues"[1]. As demonstrated above, nearly 200 of the issuers are in the Life Sciences or Healthcare sector, a sector specifically identified by New SRO in the FT Study as having a significant number of Security Outliers. Many of the issuers in the Healthcare Sector are cannabis companies.

It is of note that New SRO has anecdotally observed that "settlement issues follow some marijuana stocks as they graduated from one exchange to another"[2]. These findings are consistent with the views of the issuers. As we indicate below, we do not think that the response to the findings (and concerns from an important user group of Canada's equity capital markets) should necessarily be addressed through more requirements relating specifically to short selling (for example, a pre-borrow requirement). In our view, the existing rules, with some modification, should be sufficient to address issuer concerns. Increased transparency of short selling activity modeled after the framework established in the United States under Regulation SHO, including, prescriptive rules for buy-ins and expanded short reporting (investment managers, for example), and specific focus on desk reviews would go a long way to addressing the concerns of market participants. We look forward to working with the CSA, New SRO and CDS to develop and administer these solutions.

Concerns shared with CSE staff by CSE Listed Issuers

As an exchange, we have the privilege of working closely with our listed issuers on their journey as a public company. We can state with certainty that it is an article of faith among the leadership group of the CSE's issuers and the parts of the trading community focused on the early stage company market, that abusive short selling is a feature of the Canadian equity capital markets. Whether this sentiment is backed by specific evidence or not, the

[1] *Failed Trade Study*, Investment Industry Regulatory Organization of Canada, December 8, 2022, pg 15. Available at: https://www.iiroc.ca/media/20671/download?inline

[2] Ibid, page 16.

belief is a common one.

Over the years, we have been advised by several of our issuers that their securities have been the target of abusive short selling tactics that coincided, in particular, with financing activities of the company. They have described to our staff instances of down turns in the price of their securities which coincided with, in their view, an organized effort by short sellers when raising additional capital. CSE companies are not currently margin eligible and are largely held in fully paid accounts, making it extremely difficult (or even impossible) to borrow in advance of the short sale or to acquire in the open market following the short sale in order to make good delivery to the purchaser of the shares within the T + 2 time frame required to avoid a failed trade. Consequently, it is something of mystery to market participants as to how a significant short position can be assembled in these securities.

In the FT Study, New SRO identified Security Outliers as securities that met two conditions: **"**first, where there is more evidence of settlement issues relative to their peers; and second, where there is a significant amount of settlement **"**[3]**.** According to Table 6 of the FT Study, CSE had 68 securities that were identified as Security Outliers. Which, at nearly 9%, is a statistically significant percentage of the total issuers listed on CSE and causes us concern.

As further noted in the FT Study, CSE's Security Outliers were "dominated" by securities in the Healthcare sector. Interestingly, CSE's outliers had "more issues relating to TFT and noticeably less for CNS [continuous net settlement]"[4]. In a TFT transaction, settlement occurs" directly between two CDS participants"[5].

Current Regulatory Regime – Need for Transparency

We believe that the rules and regulations currently in place in Canada for short selling are sufficiently robust to address most instances of abusive short selling practices. However,

[3] *Failed Trade Study*, Investment Industry Regulatory Organization of Canada, December 8, 2022. Available at: https://www.iiroc.ca/media/20671/download?inline

[4] Ibid, page 15.

[5] Ibid, page 3.

we do think that more transparency is required to address the concerns of market participants. Specifically, we submit that Canadian transparency should be harmonized with the approach taken in the United States, where appropriate. For example, consideration should be given to large short position reporting by investment managers, as proposed by the SEC in 2022.

Trade Desk Reviews or New SRO Requirements

As we wrote above, we believe that the rules and regulations concerning short selling are generally appropriate. However, as our submission notes, the regulatory regime can be enhanced with review of delayed settlement activity under the current rules. The New SRO should be in a position, during trade desk reviews at the investment dealers to specifically target instances of delayed settlement of trades. Are these delayed settlements more frequent in instances of short sales? Are investment dealers properly marking short sale trades in accordance with the UMIR requirements? Is there a correlation of activity with financing activity by the company whose securities are being sold short? The results of these reviews, combined with the amendments to the rule framework proposed above, would go a long way to restoring confidence in Canada's secondary markets.

Prescribed Buy-in Timeframes

We are of the view that more specific requirements should be introduced with respect to buy-ins. The prevailing perception among market participants in the junior capital space is that the lack of a mandatory buy in for post-T+2 delivery of sold securities unduly facilitates (and reduces the risk of) short selling activity. It also explains why examining the "failed trades" report may not be the best indication of potentially abusive short selling practices. We suggest that the structure provided in US Reg SHO providing for a prescribed buy-in rule should implemented in Canada. This would address, in our submission, concerns around extended short positions that are not being settled. The CSE will gladly work with Staff and the Industry at large to determine what a suitable number of days is before a prescribed buy-in is triggered. The prescribed buy-in timeline should be robust enough accommodate numerous factors such as the category of Issuer (junior/senior) or type of instrument

(equity/ETF/other), but ultimately there should only be one prescribed buy-in timeframe for all securities so as not to increase complexity for the market.

Conclusion

We are pleased to work Staff of the CSA and the New SRO to meet and discuss the issues that we have raised and provide thoughts and suggestions around enhancing the regulatory framework.

Sincerely,

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APPENDIX A

Questions

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.**

CSE Response: As we noted earlier, the current regulatory regime is generally sufficient. New SRO's additional guidance, released in August of 2020 as 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* also served to appropriately clarify regulatory expectations and eliminate the interpretations of the regulatory requirements that were being used to avoid them.

Nevertheless, if it is determined that additional changes are necessary, we believe that, given the proximity and interconnectedness of our capital markets and those in the U.S., any changes should seek to harmonize, as appropriate, reporting requirements and be designed to work with the U.S. regime.

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

CSE Response: Changes to existing requirements will always introduce an administrative burden on market participants. However, if the changes improve the perception that individual marketplace participants have of the Canadian Capital Markets, then, the costs will outweigh the benefits. However, as indicated above, we do not agree that a pre-borrow requirement is necessary.

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

CSE Response: The definition of failed trade set out in UMIR Rule 1.1 appropriately describes a failed trade.

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.**

CSE Response: The current timeline of ten days following the expected settlement date is far too long. A shorter timeline would not only improve transparency but would also reduce the potential for abusive short selling practices.

The 10-day timeline may have been appropriate when the Extended Failed Trade Report was introduced in 2008, however, since that time, nearly 15 years later, capital markets have moved to T+2 settlement cycles with a T+1 settlement cycle looming on the horizon. Administrative processes have also been significantly sped up with the introduction of newer technology, software, and platforms.

A failed trade should be reported as soon as it is apparent that the trade will fail. We believe that an additional 2 or 3 days after the standard settlement cycle of T+2 is sufficient to identify and report such failed trades. Once the move to T+1 is implemented, the reporting timeline would need to be further reduced to reflect the shorter settlement cycle.

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.**

CSE Response: Yes. Additional transparency requirements in line with Reg SHO should be considered.

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.**

CSE Response: Considering a new requirement for institutional investment managers to report short positions on a monthly basis could help address some of the concerns we've described above. The aggregate short data could then be made publicly available.

7. **As noted above, New SRO'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.**

CSE Response: Yes. It is our view that the transparency should more closely align with the requirements of Reg SHO, where appropriate. We also think that more prescriptive buy-in requirements should be introduced.

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.**

CSE Response: Yes, we are of the view that the Canadian requirements should be similar. Specifically, enforcing mandatory buy-ins after a set number of days would be one more step towards preventing abusive short selling.