Canadian Forum for Financial Markets
CFFiM
Forum Canadien des Marchés Financiers
FCMFi

PROPOSED AMENDMENTS TO OSC RULE 48-501 TRADING DURING DISTRIBUTIONS, FORMAL BIDS AND SHARE EXCHANGE TRANSACTIONS AND PROPOSED CHANGES TO COMPANION POLICY 48-501 TRADING DURING DISTRIBUTIONS, FORMAL BIDS AND SHARE EXCHANGE TRANSACTIONS (THE "PROPOSED AMENDMENTS")

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Submitted via E-Mail

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RE: PROPOSED AMENDMENTS TO OSC RULE 48-501 TRADING DURING DISTRIBUTIONS, FORMAL BIDS AND SHARE EXCHANGE TRANSACTIONS AND PROPOSED CHANGES TO COMPANION POLICY 48-501 TRADING DURING DISTRIBUTIONS, FORMAL BIDS AND SHARE EXCHANGE TRANSACTIONS (THE "PROPOSED AMENDMENTS")

The Canadian Forum for Financial Markets (CFFiM) /Forum Canadien des Marchés Financiers (FCMFi), is dedicated to moving forward proposals to demonstrably grow healthy, competitive financial markets in Canada for the greater good.

We are a mission-first, values-driven, purposeful, and reform-minded organization committed to Canada's broader economic interests.

We offer constructive analysis, as a solutions partner, to stimulate capital raising, regulatory modernization and inclusive growth for the national economic competitiveness needed to meet the next decade's challenges.

I. EXECUTIVE SUMMARY

Regulation should be based on empirical data and consider the distinct features and market trends of Canada's own capital markets.

We support the OSC in a focus on regulations that grow a market for all companies, large and small, show flexibility and deference to the market participant's professional judgement and reflect the real risks and benefits posed to the Canadian market.

The Proposed Amendments have not been guided by meaningful disclosed data or analysis. No empirical evidence has been produced to show that there is a pervasive, quantitative, or qualitative problem that needs to be solved through Proposed Amendments...

A strict liability, short-sale restriction imposes limitations and compliance administration costs on firms without addressing a clear problem. A detailed and contextual analysis of a distribution, formal bid or share exchange transaction is important. It creates the boundaries necessary for a proportionate response.

Canada's current legislative and regulatory requirements are extensive. The requirements of proof of intent reassure the public that law and regulation are fair, focused and not arbitrary.

The Capital Markets Tribunal (CMT) is unique within Canada. The CMT brings independence, impartiality, and expertise. The CMT upheld a triangular hedging transaction that involved a short sale of freely traded securities borrowed from an insider and collateralized by restricted shares purchased contemporarily through private placement with the company. Contrary to the OSC's allegations, the transaction did not constitute an indirect offering of securities or engage the CMT's public interest jurisdiction, there was no material undisclosed information and no market manipulation. Rather, the CMT recognized the legitimacy of profit motive among market participants and concluded that the designed compliance with regulation did not constitute avoidance. The Proposed Amendments do not reflect the CMT's findings.

The relatively small size, lower liquidity and less active short selling in Canada make a direct or wider transplant of SEC Rule 105 concerning.

Importantly, Canadian startups/venture firms, including reporting issuers, are the drivers of innovation and often develop needed disruptive technologies in artificial intelligence, clean energy, biotechnology, fintech, and other high-growth sectors. They are vital to Canada's economic and technological landscape They face significant profitability challenges and need multiple and alternative funding over an extended period of time. Canada's economy struggles with 'scale -up' - there are fewer large, globally competitive companies in Canada compared to other advanced economies, partly due to capital constraints. The funding gaps at early and growth stages prevent the broader economic and societal benefits from these firms' technologies, products, and solutions. The Proposed Amendments augment rather than ease this challenge.

II. AN OVERVIEW OF THE PROPOSED AMENDMENTS

A. Strict Liability

The Proposed Amendments would give rise to a strict liability offence. They would apply to distributions by reporting issuers in Ontario to prohibit any person or company who made a short sale (as defined therein) of a security during the period commencing five business days prior to pricing of a prospectus offering or private placement of the same class of securities sold short from buying securities in the offering unless an exemption is available.

The purchase of securities in the offering is prohibited even if (i) the short seller had no prior knowledge of the offering, (ii) the offering did not constitute a "material fact" or "material change" concerning the issuer, and (iii) the short sales had no impact on the market price of the securities sold.

B. Another Definition of Short Sale

'Short sale' for the purposes of the Proposed Amendments (with different definition in UMIR Rule 1.1) would be any sale of a security: (i) where the seller does not have title to the security sold; or (ii) that is settled or intended to be settled by the delivery of borrowed securities.

C. Stated Concerns

The Proposed Amendments are described as addressing the following concerns:

(i) A person or company learns of an upcoming financing by an issuer that has not been publicly announced and makes short sales in advance of the announcement intending to close out the short position by buying back securities in the financing, which, according to the Proposed Amendments, will almost always be priced at a discount to the current market price, thus locking in a profit. Such short-selling activity is not driven by any fundamental views on the price of the security but rather by an opportunity to arbitrage the difference between the current market price and the offering price.

(ii) Short selling itself may depress the market price, in turn lowering the price at which securities are sold in the financing.

III. ADDRESSING THE STATED CONCERNS

It is common but not automatic that the short can be covered at a discount through the financing. Though many financings are structured at a discount to the current market price to attract investors, which gives a cushion to the short seller, the financing could be at par or at a premium in some cases, depending on demand, market conditions, or negotiated terms. If the short sale is purely speculative and intended to arbitrage the discount in the financing, the seller expects the financing to be at a discount, but that's market dependent. If the financing price ends up higher than expected, the short seller could incur a loss. Therefore, the short seller is exposed to the risk that the financing price may be equal to or above the current market price, which could make covering the short unprofitable.

In addition, short selling may, at times, depress market price and this may in turn lower the financing price, but it's not guaranteed. The effect depends on market liquidity, size of the short, and timing. In liquid, heavily traded securities, small, short positions usually don't materially move the price. In highly liquid securities, the effect of short selling on price may be negligible. The market may move differently due to other factors, and the financing price may not reflect the temporary dip from short selling.

Also, while normally, a short seller profits when a stock goes down, there are scenarios where a short seller wants the shares to rise. For example, for a short seller who believes a stock is undervalued, a small rise in the stock price could allow them to buy back part of their short position. Also, as part of a hedging strategy, traders may short a stock but hold other positions (options, futures, or correlated stocks) that benefit if the stock rises as part of an overall portfolio strategy, while holding a short position.

Finally, short selling within the parameters of Canada's current legislation and regulation, brings price discovery, liquidity, risk management (hedging) and market efficiency. For example, institutional investors, market makers and funds may use short positions to hedge long positions or reduce portfolio risks, making the market more attractive to large investors.

IV. THE RECENT FOCUS ON THE REGULATORY REGIME GOVERNING SHORT SELLING

The Proposed Amendments recognize there has been increased focus on the regulatory regime governing short selling in Canada.

The Proposed Amendments are described as a complement to other initiatives to modernize short sale regulation by the Canadian Investment Regulatory Organization (CIRO): strengthening the obligation of CIRO dealers members entering short sell orders on a marketplace to have a reasonable expectation to settle any resulting trade at the time the order is entered[1] and a proposed requirement for dealers to

[1] Solving for a Problem That Does Not Exist for Short Sale Settlements April 12, 2024

close out fail-to-deliver positions in the event of settlement failure at a clearing agency.[2] Each of these proposals raised concern regarding lack of supporting data and negative impact on the competitiveness of Canadian markets, taking its unique characteristics into account.

The Proposed Amendments are based exclusively on a recommendation from the Capital Markets Modernization Taskforce (Taskforce), in its Final Report (Taskforce Report) to prohibit short selling in connection with prospectus offerings and private placements.

The Taskforce stated that short selling in connection with prospectus offerings and private placements, and in particular bought deals pre-arranged with hedge funds who short the stock before the bought deal is announced, makes pricing and completion of offerings more difficult. According to the Taskforce Report:

> Since prospectus offerings and private placements are generally priced at a discount to the market price, market participants and investors who expect to purchase under the offering may seek to profit through aggressive short selling prior to the offering to depress the price of the offering.

(See above comments: Addressing Stated Concerns.)

The Taskforce recommended that the OSC adopt a rule prohibiting market participants and investors who have previously sold short securities of the same type as offered under a prospectus or private placement, from acquiring securities under the prospectus or private placements like the U.S. Securities and Exchange Commission Rule 105 of Regulation M: Short selling in connection with a Public Offering.

The aforementioned would not require the regulators to prove intent – a strict liability offence. (See above description: Strict Liability.)

A strict liability offence brings administrative convenience to the OSC. However, it raises concern when considered against the extensiveness of Canada's current regulatory regime, the nature of Canada's market and the lack of supporting data identifying any systemic issue.

V. THE EXTENSIVENESS OF THE CURRENT REGULATORY REGIME

A. The Proposed Amendments

The Proposed Amendments stipulate that existing rules prohibiting manipulative or deceptive trading or trading with knowledge of undisclosed material information would continue to apply to all trading activity, including short sales. UMIR rules governing short selling and manipulative trading would also continue to apply.

The Proposed Amendments recognize that there are current requirements that could potentially apply to short selling in advance of a prospectus offering or private placements, such as:

- Market participants and investors who have access to material undisclosed information

[2] Short Sales Regulation in Canada - Think Again on US Alignment April 10, 2025

concerning the offering would be precluded from short selling by the insider trading prohibition.

- The underwriter registration requirement may apply to market participants and investors who sell short in advance of an offering and fill their short position through the offering, since this is a form of indirect distribution.

- Insiders of the issuer who enter securities lending arrangements in connection with short sales prior to an offering would be subject to reporting requirements; such transactions may also be limited by the insider trading prohibition and applicable blackout periods; and

- The prohibition on market manipulation may apply to conduct that artificially depresses the price of the securities.

They also properly recognize that these requirements require detailed and contextual analysis.

B. The Capital Markets Tribunal

Detailed and contextual analysis is important. It creates the boundaries necessary to ensure a proportionate response.

The Capital Markets Tribunal (CMT) is unique within Canada. In 2022, Ontario created the CMT as a separate adjudicative body distinct from the OSC. The OSC regulates, investigates, and prosecutes. The CMT hears enforcement cases and certain applications independently of the OSC. The CMT brings independence, impartiality, and expertise.

In Cormark Securities Inc (Re), 2024 ONCMT 26, summarized at Schedule A, the OSC made and failed to prove various allegations including that the respondents engaged in conduct subject to the Tribunal's public interest jurisdiction. The CMT upheld a triangular hedging transaction that involved a short sale of freely traded securities borrowed from an insider and collateralized by restricted shares purchased contemporarily through private placement with the company. The transaction did not constitute an indirect offering of securities or engage the CMT's public interest jurisdiction, there was no material undisclosed information and no market manipulation. Rather, the CMT recognized the legitimacy of profit motive among market participants and concluded that the designed compliance with regulation did not constitute avoidance.

According to the CMT:

a) It is reasonable for market participants to have an expectation of profit.

b) "Hedging or managing risk is a normal and accepted part of participating in the capital markets. Merely because a structure might reduce or eliminate risk does not make it contrary to the animating principles of the Act."

c) "Market participants can and do trade for reasons other than an issuer's merits and that all trading, regardless of the traders' reasons for being in the market, contribute to pricing a security. Short sales are a common element in many trading strategies.

d) The use of knowledge and skills, and benefiting from those efforts, is what is expected of market participants and registrants.

Similar to the CMT, we are unable to conclude that a simple requirement that does not require regulators to prove intent is preferable.

C. Current Legislative and Regulatory Requirements.

In addition, the current legislative and regulatory requirements are extensive. They include:

i. Insider Trading

Information is considered material if a reasonable investor would likely consider it important in making an investment decision, or if it would reasonably affect the market price of the security. The information is non-public if it has not been generally disclosed to the market. An upcoming financing by an issuer (a debt or equity offering) that has not been announced generally qualifies as material non-public information (MNPI) where they affect capital structure, dilution, or share price. Small, routine, or 'effectively public' financings would not be considered MNPI. If the details are uncertain, speculative, or unlikely to affect share price, they may not meet the materiality threshold. (For example: preliminary discussions with lenders that may or may not lead to a financing.)

Where MNPI applies, the following sections of the Ontario Securities Act address insider trading:

- Section 76(1): Prohibits any person who has knowledge of a material fact or material change about a reporting issuer that has not been generally disclosed from purchasing or selling securities of that issuer. Covers insiders (directors, officers, employees) and others who acquire material non-public information.

- Section 76(2): Prohibits tipping—providing material non-public information to someone else who trades or encourages others to trade. Liability extends to the tipper and the tippee.

- Section 76(3): Allows the Ontario Securities Commission (OSC) to make orders to prevent further trading, such as cease-trade orders, where insider trading is suspected.

- Section 77: Requires insiders of reporting issuers to file reports of trades in their securities with the OSC within prescribed timelines.

- Section 122(1)(c): Prohibits misleading statements or information in any document or communication.

- Section 126.1(1)(a): Fraud in connection with securities trading.

- Section 126.2(1): Market manipulation and misleading appearance of trading (overlaps with synthetic wash trading).

- Section 126: Prohibits fraudulent trading practices, including deceit, misrepresentation, or misleading statements in connection with the purchase or sale of securities regardless of intent to defraud.

Insider trading is also prohibited by sections 380 and 382 of the Criminal Code.

We recognize that insider trading may be difficult to identify. This may be addressed through various tools which include circumstantial and pattern evidence, data analytics and surveillance, and co-operation with whistleblowers. It has long been understood that this offence requires proof of knowledge and intent for good reasons which include fairness to market participants, protection of legitimate market activity, proportionality, and market confidence. A regime requiring proof of intent reassures the public that law and regulation are fair, focused and not arbitrary.

ii. *Wash Trading and Market Manipulation*

Arbitrage is also addressed through wash trading and market manipulation regulation and legislation in addition to OSC Rule 48-501, Trading During Distributions:

National Instrument

National Instrument 23-101: Trading Rules: Requires fair and orderly trading practices and prohibits conduct that could manipulate or distort market prices.

National Instrument 21-101 Marketplace Operation Rules: Applies to exchanges and alternative trading systems, ensuring they implement policies to detect and prevent manipulative activity.

Universal Market Integrity Rules (UMIR)

Rule 2.1 Prohibits entering orders or trades with the intent to create a false or misleading appearance of market activity or manipulate the price of a security.

Rule 2.2: Prohibits any conduct that is fraudulent or deceptive, including misleading statements or schemes.

Rule 4.1 & 4.2: Restrictions on entering orders that are misleading or not for bona fide trading purposes.

Ontario Securities Act

Section 126.1(1)(a): Fraud (covers conduct with intent to deceive the market, even if there is no direct loss).

Section 126.2(1): Prohibits: (a): Creating or attempting to create a false or misleading appearance of trading activity and (b): Creating or attempting to create an artificial price.

Section 118: Prohibits acting fraudulently or deceitfully while trading or advising.

Manipulative trading is also prohibited by sections 380 and 400 of the Criminal Code.

iii. *Insider Reporting Requirements*

National Instrument 55-104: Insider Reporting Requirements and Exemptions

Securities lending by insiders prior to an offering must be reported.

Section 1.1: “related financial instrument” means an agreement, arrangement or understanding to which an insider of a reporting issuer is a party, the effect of which is to alter, directly or indirectly, the insider’s economic interest in a security of the reporting issuer or the insider’s economic exposure to the reporting issuer.

Note: A “related financial instrument” includes a securities lending transaction prior to an offering. (See also NI 55-104CP)

Section 3.1: Requirement to report changes in ownership/control: An insider must file an insider report disclosing any change in:

- beneficial ownership of securities of the reporting issuer, or
- control or direction over securities of the reporting issuer.

Section 3.3: The insider report must be filed within 5 calendar days of the transaction.

V. A BRIEF COMPARISON TO US RULE 105

As described in the Proposed Amendments, they are broadly aligned with Rule 105.

However, they are wider in scope in terms of the type of offering they would apply to, specifically to public offerings on a “best-efforts” basis and private placements, which are addressed by the market in the U.S. Subscription agreements may include investor representations that the investor will not short or hedge until the transaction is announced/closed. If breached, allocation may be denied or participation rescinded. Investors may also complete no-short questionnaires/certification. Deals may have post-close lock up requirements. Trading surveillance (often through prime brokerage and clearing data) may be available to screen accounts for shorting ahead of an allocation request.

VI. THE NECESSITY OF A COST BENEFIT ANALYSIS

A. The Requirement

Section 143.2(2) of the Ontario Securities Act mandates that the OSC publish a notice of its proposed rule, which must include:

> “a description of the anticipated costs and benefits of the proposed rule.”

This provision requires the OSC to provide a qualitative and quantitative analysis of the anticipated costs and benefits associated with a proposed rule.

Section 2.1(6) of the Ontario Securities Act provides that business and regulatory costs and other restrictions on the business and investment activities of market participants should be proportionate to the significance of the regulatory objectives sought to be realized. This provision underscores the importance of evaluating the economic impacts of regulatory changes to ensure they are justified and proportionate.

B. The Cost Benefit Analysis Provided

Staff considered maintaining the status quo but relied only on the Taskforce finding that bought deals pre-arranged with short sellers who short before the bought deal is announced are problematic in Canadian markets, particularly within capital-intensive industries. The Taskforce findings contained no supportive data of any kind including any evidence of a systemic wide problem that would not be addressed by current rules and legislation.

Staff did not rely on any unpublished study, report, or other written materials other than the Taskforce Report, which did not provide data.

According to the cost benefit analysis produced, the current regulatory framework does not explicitly address the issue of closing short positions with securities issued from treasury, either in a prospectus offering or a private placement. The current extensive regulatory regime can address this as per Section IV.

Also, according to the cost benefit analysis produced:

- It is not possible to quantify the costs and benefits of the proposed amendments as there is not sufficient publicly available data or other data available to the Commission on participation by short sellers in distributions.

- There is also no requirement to keep records of this activity.

- Reliance is placed on SEC release dated July 28, 2004, that the SEC found that the major costs would be borne by traders and firms that derive significant revenue from closing pre-pricing short sales with securities sold in an offering. On this basis, Staff expect that compliance costs will not be significant other than for firms engaging in the conduct prohibited by the Proposed Amendments to a significant degree.

Notwithstanding the above conclusion that it is not possible to quantify the costs and benefits, the stated benefits are described as being that issuers may receive a higher issue price, short sellers get regulatory certainty and uninformed investors will not trade against short sellers who intend to close their short positions with new issue equity securities. It is also stated that clarity will help dealers meet their compliance obligations. No evidence of benefit or need has been produced.

The stated costs are described as being that issuers may have fewer potential buyers of securities in a financing (namely short sellers). It is stated that the Proposed Amendments may make it more difficult to close short positions in the market at an acceptable price, that other investors may experience a mixed impact and, that to the extent that certain short selling negatively affects the market price of the issuer's security, purchasers in an offering will pay a higher price, but existing shareholders will experience less economic dilution.

The stated costs and benefits described are purely hypothetical.

VII. "WHAT IS THE PROBLEM WE ARE SOLVING FOR?

As stated, the Proposed amendments have not been guided by meaningful disclosed data or quantitative analysis. No empirical evidence has been produced to show that there is a pervasive, quantitative problem that should be solved through Proposed Amendments because regulations to address the problem do not exist.

VIII. CANADA'S PRINCIPLE-BASED APPROACH TO REGULATION.

A. The Governing Principles

The Canadian marketplace is unique and should be nurtured with a regulatory framework which focuses on promoting its competitive advantages and enhancing its global position. Regulation should consider the distinct features of its own capital markets empirical data and market trends specific to Canada. A closer look at US alignment is prudent with careful regard as to where supported and where it should be responsibly distinguished.

In addition, Canadian regulators must focus on regulations that support a market for all companies, large and small.

Flexibility and deference to the market participant's professional judgement that reflect the real risks and benefits posed to Canadian market is important.

B. The Application of a Principle-based Approach

As we have previously described, Canada has three radically different equity market pools:

1. Highly liquid, deeply traded, mostly non-intermediated interlisted equity securities markets. Canada is the only nation in the world that has a freely traded "interlisted' market with the United States, the largest capital market in the world. Our large cap companies benefit from exposure and liquidity in the United States allowing their securities to trade as naturals. The global peer set of securities resembling the trading activity of these names would be S&P small and mid-cap companies. The interlisted capability is a unique and competitive advantage of the Canadian market on a global scale.

2. A liquid, intermediated, non-interlisted senior equity securities market, consisting of the majority of the non-interlisted names qualifying for listings on the senior Toronto Stock Exchange and trading as Tier A liquidity securities. The peer set for these companies would be commonly held equities which are domestically traded in markets such as – Australia, Italy, and the Scandinavian countries. While not unique in and of itself, this tier of securities benefits from a highly competitive secondary trading mechanism, which itself is a unique asset to Canada compared to economies of a similar size.

3. An illiquid, Tier B security, heavily intermediated secondary trading of junior and venture oriented equity securities which number in the 1000s across a variety of junior exchanges including TSX venture and the CSE. Market capitalizations range from 1/2mm to over $100mm. These provide primary financing opportunity and may be seen as a unique and competitive advantage for our markets on a global scale, though challenged on a secondary trading basis.

Canada needs to consider whether U.S. large cap sized oriented regulation fits Canada's mid cap and small cap market. As compared to the United States, Canada has a larger number of illiquid securities. Canada's fewer liquid names, with narrower shareholder base, coverage, and tighter management ownership also have less efficient information flows than widely held securities, whose products are consumed globally.

Arbitrage issues raised are more impactful to Tier 2 and 3 in Canada than in the United States. They face challenges in terms of cash flow and profitability and the incentives of counterparties financing and trading the security. This is due to a more concentrated market, less options and illiquidity.

Generally, liquidity and price discovery are especially important for junior listed securities who often have no ready access to stock lending facilities, i.e., not widely held. Junior and illiquid issuers may occasionally experience a significant reduction in liquidity and other participants may not readily enter the market. These illiquid securities are thinly quoted.

C. Canadian Start Ups/Venture

i. The Benefits

Within Tier 3, Canadian startups and venture reporting issuers, are the drivers of innovation and often develop needed disruptive technologies in artificial intelligence, clean energy, biotechnology, fintech, and other high-growth sectors. While startups/venture firms may struggle to be profitable initially, they push Canadian industries forward and help Canada remain competitive globally. They contribute to GDP growth, are major sources of high-skilled employment, and, subject to financing, can scale quickly, generating multiplier positive effects in the economy including foreign investment.

Canadian startups and venture-stage companies are vital to Canada's economic and technological landscape. Their impact extends beyond innovation, contributing significantly to job creation, economic diversification, and global competitiveness.

Without a vibrant startup ecosystem, Canada risks losing talent, investment, and technological leadership to other countries.

ii. The Challenges

Canadian start-ups face significant funding challenges. Key issues include a lack of domestic investment for scaling companies, difficulties in securing lead investors, and a shortfall in capital. [3] 2024/2025 have been marked with a decline in overall early-stage funding for venture capital.[4]

The result is Canadian startups and venture issuers face significant profitability challenges. They need multiple funding rounds. The average age of Canadian startups raising their first round, increased to 3.65 years in 2023, the highest in the last 10 years. This delay indicates that companies are waiting longer to secure funding, often due to the challenges in achieving profitability and the need to demonstrate more mature business models before attracting investors.[5]

The Proposed Amendments limit alternative financing and therefore add to, rather than alleviate, funding challenges for start-ups.

[3] Business Trying-to-Scale-Up-in-Canada-Face-Multiple-Challenges-With-No-Silver-Bullet-Solutions: Research Money Inc; ; Hard-Truth-Climate-Startups-Developing-Hard-Tech-Solutions-Face-a-Formidable-Funding-Gap: MaRS.

[4] CVCA, Q1 2025 Venture Capital Key Findings; Key Takeaways- CVCA Yearend 2024 Canadian Market Overivew: Faskens

[5] . Start Up Funding: What Should We Expect? Réseau Capital

In Summary:

In summary relative to the United States, Canada has:

- Smaller market, fewer participants, less liquidity for many mid-cap and small-cap stocks. Market participants may rely on different hedging strategies. Limiting short selling prior to offerings could intensify illiquidity, making it harder for issuers to execute offerings efficiently.

- A considerable proportion of offerings are smaller, retail-focused, or cross-listed, with fewer hedge funds shorting aggressively beforehand. The problem that Rule 105 solves in the U.S. (short sellers depressing the offering price) may be less pervasive in Canada.

Enforcing a strict short-sale restriction imposes restrictions and compliance administration on firms without addressing a widespread problem. The relative smaller size, lower liquidity and less active short selling in Canada make a direct transplant of SEC Rule 105 concerning.

IX. QUESTIONS POSED

In addition, with a view to certain of the additional questions posed:

a) It is incorrect to assume that a 5-day period based on Rule 105 will ensure that in a marketed offering, a short seller intending to participate in the offering would not have an opportunity to adversely affect the market price of the offering through short sales immediately before pricing of the offering, as any activity from before that period should no longer be reflected in the market price of the offered securities is not correct.

   Different securities have different information flows. Considerations include liquidity of a security, its float and management/insider ownership.

b) The issuance of press releases simply further reinforces that information flows differently (in terms of speed, and breadth) for different securities tiers. An illiquid security not broadly followed, without a dedicated market maker, is going to have slower, and less broad dissemination. A press release is a pull not a push notification – that is investors need to seek its information content. In the case of broadly held securities, with many participants trading a day, the probability that one of the participants has sought it and that it is subsequently embedded in the information content of price is greater.

c) Market makers play an active role in absorbing relevant information such as “press releases” mentioned above, and they are the most likely conduit through which that information will re-price illiquid securities properly. They play an exceptional role in Canada’s capital markets. They are obligated to post continuous two-sided quotes, for both bids and offers. This ensures investors can buy and sell securities without large price gaps. Without market makers, many less-active securities such as ETFs, junior equities, and thinly traded issuers, would have wide spreads or no liquidity. Market makers contribute positively to:

Capital Formation

For IPOs, offerings, and ETF launches, market makers support price discovery and post-offering liquidity. This helps new issuers attract investors who can enter and exit positions smoothly.

Risk Mitigation

Market makers commit their own capital to fill gaps in supply and demand. Because market makers must often take on short-term inventory risk (long or short), regulators allow them special tools (short-marking exempt, insider-reporting relief, etc.) outlined below.

Systemic Stability

During periods of market stress market makers are one of the few participants obligated to continue quoting and providing liquidity.

Fair and Orderly Markets

Canadian exchanges (TSX, TSXV, Cboe Canada, CSE) require designated market makers to help maintain an "orderly market": continuous liquidity, price stability, narrowing bid–ask spreads.

Market makers' distinctive role is recognized in policy and rule development by the CSA, the Canadian Investment Regulatory Organization, and marketplaces. These exemptions and accommodations are listed below:

a) NI: 55-104 Insider Reporting Requirements and Exemptions

Section 7.2: A market maker does not need to file insider reports for trades in securities of an issuer if the trades are made in the ordinary course of market-making activities.

Sections 1.2, 7. 3: Exemption for market maker trades in related financial instruments.

b) NI 62-103: The Early Warning System and Related Take-Over Bid and Insider Reporting Issues

Section 9.4: A registered dealer acting as a market maker is exempt from the early warning and insider reporting requirements if the acquisition or disposition of securities is made in the ordinary course of their market-making activities.

c) NI 62-104: Take Over Bids and Issuer Bids

Section 4.1: A market maker that is a registered dealer is exempt from the formal take-over bid and issuer bid requirements of NI 62-104 when it acquires or disposes of securities in the ordinary course of its market-making activities.

d) NI 45-102: Resale of Securities

Section 2.14: A trade by a market maker in the ordinary course of their market-making activities is deemed not to be a distribution under securities law.

Section 2.8: To ensure that market makers can immediately resell securities acquired in the course of providing liquidity, a first trade of a security by a market maker, acting in the ordinary course of its market-making business, is not subject to the hold period restrictions that would otherwise apply.

e) Universal Market Integrity Rules

Rules 3.1 & 3.2: Market makers are exempt from certain short sale restrictions when they are fulfilling their market-making obligations. If a security is subject to a "short sale tick test" or has been designated as "short sale ineligible," a Market Maker can still sell short during bona fide market making.

Rule 2.2: Market makers may be exempt from what may otherwise look like *"spoofing" or "wash trading"* if the trades are part of a recognized market-making strategy (e.g., maintaining a two-sided quote, crossing stock to balance inventory) when acting under exchange-approved market-making obligations.

Rule 6.3: Market makers may be exempt from order exposure requirements when filling orders as part of their liquidity obligations.

Rule 6. 2 & 6.6: Market makers are allowed to trade odd lots or extended settlement transactions in ways other participants cannot, again to ensure liquidity and orderly markets.

Rule 7.7: Restricts 'dealer restricted' persons during an offering from certain bid/purchases in the restricted security subject to carve outs for persons with marketplace trading obligations to continue market stabilization.

f) Marketplace Rules

Canadian marketplaces grant market makers additional exemptions, such as reduced margin requirements, permission to engage in stabilization trading and flexibility around order exposure and client-priority rules.[6]

Market maker exemption has not been meaningfully reflected in the Proposed Amendments.

We are pleased to discuss this correspondence with you further at your convenience.

Respectfully submitted,

The Canadian Forums for Financial Markets

[6] TMX TSX | TSXV | Market Maker Program; Market Maker Program | The Canadian Securities Exchange (CSE)

SCHEDULE A

Cormark Securities Inc (Re), 2024 ONCMT 26

A. The Facts

On March 17, 2017, Canopy Growth Corporation ("Canopy") was added to the Toronto Stock Exchange's composite index (the Index). Prior to Canopy's inclusion in the Index, Cormark Securities Inc. (Cormark"), a registered investment dealer approached Canopy about participating with a Cormark client in a series of transactions (the Transactions). The Transactions would allow Canopy to raise capital by taking advantage of the anticipated increased demand for Canopy shares on March 17, 2017. Transactions were conducted when Canopy was added to the Index. Transactions also involved Cormark's clients Bistricer and his company Saline Investments Ltd. Murray Goldman, a Canopy shareholder, and a member of its board of directors, also participated in the Transactions.

The OSC made and failed to prove various allegations including that the respondents engaged in conduct subject to the Tribunal's public interest jurisdiction.

The Transactions were:

a) Canopy sold 2.5 million common shares to Saline in a private placement, subject to a four-month hold period (the Restricted Shares).

b) Saline borrowed 2.5 million freely-trading Canopy common shares (the Free-Trading Shares) from Goldman Holdings under a securities loan agreement.

c) Saline provided the Restricted Shares to Goldman Holdings as collateral for the loan of the Free-Trading Shares; and

d) Saline sold short 2.5 million Canopy common shares on the Toronto Stock Exchange through a series of sales on the open market and in the exchange's market-on-close facility, using the Free-Trading Shares to settle the short sales.

The Restricted Shares carried a legend indicating that they were subject to a four-month hold period. The Restricted Shares remained in Goldman Holdings' account at Cormark until the end of the hold period when the legend was removed. The Restricted Shares were retained by Goldman Holdings in satisfaction of Saline's obligations under the securities loan agreement.

B. The Findings

i. Factual Findings

The Tribunal found that the Restricted Shares remained within the closed system until the end of the four-month hold period. Saline used the Free-Trading Shares to settle its short sales. The two were distinct sets of securities.

Saline acquired the Restricted Shares and was committed to holding them for four months. There is no impediment to providing shares subject to a trading restriction as collateral for a loan and those shares remained within the closed system. The Free-Trading Shares were previously issued and outstanding and sold in the secondary market.

Saline purchased shares from Canopy under a prospectus exemption. These shares were subject to a hold period. They were provided as collateral for the securities loan and were not resold to the public. Investors buying Canopy shares through Saline's short sales on the market did not require the protection of a prospectus. They bought free-trading shares that had been issued earlier. Those shares were not, as the Commission submitted, "identical." The mandatory four-month hold period for newly issued treasury shares is designed to ensure that Canopy would make its next quarterly continuous disclosure before the restricted shares became freely tradeable and entered the secondary market.

The Restricted Shares were posted as collateral for the securities loan. A pledge of shares as collateral for a loan is excluded from the definition of 'trade" in s. 1(1) of the Act. The Restricted Shares stayed within the closed system until the hold period ended. There were no further transactions involving the Restricted Shares.

This was Canopy's first private placement transaction. The Tribunal found Canopy to be experienced in raising capital, with extensive entrepreneurial background and an experience board. Canopy's lawyer was an experienced securities counsel and Canopy relied on her advice. Canopy would have understood that there would be trades in the Free-Trading Shares on the market on March 17 and it was not concerned with whether all the shares went into the hands of index funds or indexers.

The parties benefited from the Transactions.

Canopy did not need capital at the time and Canopy would only participate on terms that were acceptable to Canopy.

The Tribunal did not agree that the structure was risk-free for Saline. Saline entered into the securities loan agreement prior to signing the Share Subscription Agreement. It agreed to the Share Subscription Agreement after entering short sales in the open market and after learning that Canopy had a floor price. If Canopy's share price dropped below the floor, Canopy could walk away from the private placement. If it did, Saline would have had no collateral to deliver for the securities loan, which would be in default, leaving Saline without Free-Trading Shares to settle the short sales. Saline accepted that risk.

The Tribunal found there was no basis to conclude that Saline's risk-reward ratio was even relevant to Canopy's decision to participate in the Transactions.

Canopy did its own assessment of how the cost of this transaction compared to its previous capital raising activities and was not misled by Cormark or Kennedy. Canopy had the information necessary to do that analysis and factored in the downward price protection provided by the negotiated floor price.

The Restricted Shares were not converted into the Free-Trading Shares. There was nothing to prevent the Restricted Shares from being used as collateral for the securities loan. The Restricted Shares remained restricted and were held for four months in Goldman Holdings' account at Cormark. The Free-Trading Shares were not subject to any hold period and there was nothing to prevent Goldman Holdings from loaning those shares to Saline and Saline in turn using them to settle its short sales.

When the hold period expired the Restricted Shares became free-trading shares. The separate identifying number for the Restricted Shares was changed by the Canadian Depository Service into the identifying number for Canopy's common shares.

There was nothing untoward about Saline and Goldman Holding agreeing to use the now free-trading shares to settle their obligations under the securities loan agreement. The securities loan agreement provided that Saline's obligation at the end of the term of the agreement was to return "Equivalent Loaned Securities" – shares that are "of an identical type, nominal value, description and amount" to the Free-Trading Shares it borrowed. Once the hold period expired and the restriction on the Restricted Shares was lifted, they became interchangeable with and therefore equivalent to the Free- Trading Shares Saline had borrowed.

No new shares were added into the public market until the hold period expired, and the Restricted Shares became free trading.

The Commission alleged that the private placement was deliberately sized so that it was not a material change, and no timely disclosure would be required. It was held there was nothing about efforts to comply with insider trading rules that were inconsistent with the animating principles underlying those rules.

Saline, wanting to ensure that its short sales would not be considered insider trading, is an attempt to ensure that it was following applicable securities law.

Had Canopy decided the private placement was material, there would have been consequences for Cormark, Kennedy and Saline. Recognizing that and seeking assurance from Canopy about whether it developed a view that the private placement was material is consistent with wanting to ensure that the Transactions would not have to be restructured or abandoned to comply with all applicable laws.

The private placement being immaterial was part of the structure. If Canopy had a different view, the structure would have been changed or abandoned.

ii. The Principles

According to the Tribunal:

a) It is reasonable for market participants to have an expectation of profit.

b) "Hedging or managing risk is a normal and accepted part of participating in the capital markets. Merely because a structure might reduce or eliminate risk does not make it contrary to the animating principles of the Act."

c) "Market participants can and do trade for reasons other than an issuer's merits and that all trading, regardless of the traders' reasons for being in the market, contribute to pricing a security. Short sales are a common element in many trading strategies. Had any party wished to, they might have sought to introduce expert evidence to assist us to conclude whether Saline's short sales had the outcomes or resulted in the risks the Commission alleges they might have had. We conclude that hypothetical outcomes that have not been established to have occurred are insufficient to conclude that the respondents did anything wrong."

The Tribunal agreed the parties using their knowledge and skills, and benefitting from their efforts, is what is expected of market participants and registrants:

> "We conclude that their conduct in this case was not improper, and we also conclude that there is no evidence that the investing public in this instance suffered from the Transactions."

"Having found that the Commission has not proven any of its numerous allegations of misleading, dishonest or other wrongful conduct, we conclude that these allegations against the respondents were an overreach. The unfortunate consequence is that the respondents have incurred significant costs due to this proceeding, both financial and reputational, which they cannot recover."