

CONFIDENTIAL

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Ms. Theodora Lam
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Dear Ms. Lam:

Re: CIRO Notice 25-001 - Proposed Amendments Respecting Mandatory Close-Out Requirements

CNSX Markets Inc (we or the CSE) thank CIRO and the Canadian securities regulatory authorities for their work to address concerns about abusive short selling practices. We are pleased to offer our comments on the proposal for a mandatory close out of fail-to-deliver positions. The CSE, as a home to a large and growing population of early-stage issuers, is aware of concerns in the early-stage capital community (including issuers, investors, investment dealers and the advisory community) related to abusive short selling in the markets. It is evident that there continues to be a meaningful lack of trust from the community on the operation of today's secondary markets. The CSE is supportive of the measures taken to date and commends the regulatory community for their focus and attention on the issues.

We provide our general comments on the proposal in this letter and respond to the specific questions raised in the notice in Appendix A.

Lack of Confidence in Junior Markets

There are two significant threats to the growth of the public equity capital markets in Canada, 1) ease of access to international listing options (primarily, but not exclusively the US) and 2) access to private capital as an alternative to public capital formation. As the world becomes more interconnected and access to global capital improves, there is growing competition from

non-Canadian listing venues and private equity firms to meet the capital formation needs of Canadian companies. Despite the work done to date, the perception that Canada has issues with abusive short selling continues to be pervasive in the junior market in particular. This concern, and an overall lack of confidence in the operation of our secondary markets, is a material factor in companies electing to stay private longer, access capital and listings opportunities outside the country and opt for private equity means of capital formation.

In our view, the proposal to impose a mandatory close-out process, when combined with recent guidance on short selling practices, will go a long way to alter public perceptions about the fair operation of the markets. Doing so will bolster confidence in the market and help steer junior issuers back to the public markets.

Existing Practices

The CSE currently administers a buy-in process on CSE listed securities, receiving each day a provisional buy-in list followed by the final buy-in list late in the day from CDS. We have frequently observed fail-to-deliver positions on the provisional buy-in list that are not included on the final buy-in list. We often see the same security, with the same quantity sought, on the provisional buy-in list that appears day after day. CSE securities are, almost by definition, 'hard to borrow', so how is it that these securities keep falling off the final buy-in, then 24 hours later, the same name in the same amount appears again on the provisional list and follow the same pattern for days on end?

There are a variety of reasons a security may not make it to the mandatory list, including¹:

- Delivery is made on the outstanding position
- The Receiver grants a system extension on the buy-in position to the Deliverer
- The Receiver requests CDS to extend the Deliverer
- The Receiver is eligible to seek a fill on their own and elects to do so instead of sending the position to the exchange

One of the key concerns with the current process is the lack of transparency, i.e., no information is provided regarding why a position is removed from the provisional buy-in list. While we acknowledge that there are *many* legitimate reasons as to why a fail-to-deliver may occur and be extended (i.e., removed from the provisional buy-in list distributed by CDS), the lack of information, and the regular pattern of conduct, leads to the assumption that improper

¹ See CDS [Chapter 8 Trade and Settlement Procedures](#) for more details.

short selling may be occurring. The process also fuels issuer and investment dealer suspicions around naked short selling, and a failure to enforce the rules.

As a recognized exchange, the CSE is not privy to the back office workflow changes required to implement a mandatory close out procedure for the Canadian market. That said, we believe that the proposed amendments are necessary to preserve the role of Canada's junior markets in providing capital formation services to early-stage companies in Canada. We believe that these amendments are in the public interest and for the benefit of the Canadian financial ecosystem. They would also strengthen the integrity and confidence in the Canadian capital markets. We welcome these changes.

If you have any questions or would like to speak to CSE further, please let us know.

Sincerely,



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APPENDIX A

Question 1

To what extent do Investment Dealer Members currently use CDS Participants for clearing and settlement that are not Investment Dealer Members? It is important that we assess the risk of regulatory arbitrage, as the Proposed Amendments would become a CISO requirement that would only affect Investment Dealer Members that are within CISO's jurisdiction.

Would the Proposed Amendments create an incentive for Investment Dealer Members to seek entities that are not regulated by CISO for clearing purposes, and/or create disadvantages for Investment Dealer Members that currently offer clearing and settlement?

*This is a legitimate concern, and we strongly believe that any rule that is implemented should apply to **all** CDS participants. If the potential for regulatory arbitrage is created, then it will be exploited.*

Question 2

Do Clearing Members, or Investment Dealers that could be allocated a fail-to-deliver position from a Clearing Member, currently have the books and records in place to close out in a timely manner pursuant to the proposed timelines? This would require the tracking of a CNS fail-to-deliver position to one of the following in order to determine the applicable close-out timeline:

- Short sales or trades resulting from SME orders that do not relate to persons with Marketplace Trading Obligations when trading in securities for which that person has obligations: S+1
- Long sales: S+3
- Persons with Marketplace Trading Obligations when trading in a security for which that person has obligations: S+3
- Deemed to own: T+35

No comment.

Question 3

We propose to allow Clearing Members to allocate all or a portion of the fail-to-deliver position to another Investment Dealer Member as long as that allocation is made in a reasonable and timely manner. Would the recent move to T+1 settlement affect the ability of Clearing Members to make allocations, or the ability of Allocated Members to close out under the specified timelines? Would Clearing Members have enough information from CDS or their

own books and records to conduct allocations in a timely manner, and if not, what types of information would be required?

No comment.

Question 4

Under the Proposed Amendments, we would expect the majority of trades in listed securities to be settled or closed out prior to ten days past settlement date, which is the current reporting timeline for extended failed trades. Given the proposed close-out requirements would apply to all sales, should we consider repealing or narrowing the reporting requirement for extended failed trades on Participants and Access Persons?

No reporting requirement should be repealed until the efficacy of the amendments has been assessed.

Question 5

Given that Investment Dealer Members may use different entities for clearing and trading purposes in Canada, would the proposed notification and reporting requirements ensure a consistent application of close-out and pre-borrow requirements similar to the regulatory framework under Regulation SHO? What are the operational or technical challenges associated with the proposed reporting or notification requirements?

No comment.

Question 6

What are some relevant factors or considerations when ensuring purchases made on a marketplace to close out a fail-to-deliver position are being executed using reasonable commercial terms in a manner that is consistent with market integrity?

For example, should there be an exception to allow the purchase of securities made to close out fail-to-deliver positions to be executed off-marketplace in order to minimize potential market disruptions? Would the ability to conduct off-marketplace trades only benefit certain Investment Dealer Members that are able to find their own counterparties away from the marketplace? Would there be a greater benefit to the market to require these trades to occur on a marketplace for transparency purposes?

No comment.

Question 7

To assist with our monitoring capabilities at CIRO, we are considering the use of a new marker for purchases executed on a marketplace for the purpose of closing out a fail to deliver position. While this marker would only be used for regulatory purposes and would not be publicly disseminated, we would like to seek feedback on whether there are any operational challenges faced by executing Participants in terms of implementing such a marker.

This depends on the format of the implementation, but if it is merely a marker on an order then it shouldn't be challenging to implement from an exchange perspective.

Question 8

Are there any common practices that are currently in place that may raise issues in complying with closing out under the specific timeframes or with the pre-borrow requirements as set out in the Proposed Amendments?

8a) Would the use of average price or accumulation accounts affect the ability of Investment Dealer Members to close out in a timely manner as required by the Proposed Amendments, and if so, how?

8b) Would the use of the SME marker for trades that are not executed by a person with Marketplace Trading Obligations in respect of their security of responsibility affect the ability of Participants to close out in a timely manner or pre-borrow as required by the Proposed Amendments, and if so, how?

No comment.

Question 9

To facilitate the operation of a close-out framework in Canada, we are proposing reporting and notification requirements as set out above. We are requesting comment on whether Investment Dealer Members anticipate any challenges with the proposed reporting and notification requirements, and if so, please specify.

No comment.

Question 10

Is the extended close-out timeline of T+35 calendar days appropriate for deemed to own securities, or should we consider a shortened close-out timeline for these transactions?

No comment.

Question 11

Are there other situations that would warrant an extended close-out timeline, and if so, what other exceptions should we consider?

Exceptions should be considered for Dealers that provide exchange market making services such as filling oddlot trades and positions in a Guaranteed Minimum Fill (GMF) facility. In the event that a Dealer is auto-filled on an illiquid security, they may not have the ability to offset their position and fail-to-deliver for multiple days in a row. It seems unnecessarily unfair to harm Dealers that are providing a valuable service to the retail trading community.

Question 12

SEC Rule 204 in Regulation SHO allows broker dealers that have not closed out fail-to-deliver positions to continue short selling as long as they pre-borrow for themselves or their clients in the affected security. Would this outcome be appropriate for Canada, or should we consider restricting short selling altogether where there is a failure to deliver?

No comment.

Question 13

Given that we are proposing extending the requirement for a reasonable expectation to settle to Investment Dealer Members that are not Participants, should we also consolidate this requirement in the IDPC Rules, rather than having separate requirements in both UMIR and IDPC Rules?

CIRO should consolidate the rules to make sure that they remain consistent and that the intention to apply the requirement to all dealers remains clear over time.

Question 14

Have we identified all the proposed provisions that will materially impact clients, investors Investment Dealer Members, marketplaces or CIRO in our Impact Assessment? If not, please list any other proposed provisions that you believe will materially impact one or more parties and why.

No comment.

Question 15

Overall, do you agree with CIRO's qualitative assessment of the benefits and impacts of the Proposed Amendments? Please provide reasons for your stance.

See general comments.

Question 16

We are proposing an implementation period of no less than six months after the publication of the final amendments, and request feedback on what implementation period would be appropriate to provide applicable Investment Dealer Members with sufficient time to make the changes necessary to comply with the Proposed Amendments.

No comment.