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VIA EMAIL

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Dear Sirs/Mesdames:

Re: **Proposed Amendments Respecting Mandatory Close-Out Requirements**

TMX Group Limited ("**TMX**" or "**we**") welcomes the opportunity to comment on the proposed amendments respecting mandatory close-out requirements ("**Request for Comment**" or "**Proposal**") published by the Canadian Investment Regulatory Organization ("**CIRO**") on January 9, 2025. TMX supports the implementation of requirements that would improve settlement discipline in Canada, and encourages CIRO to engage further with industry participants to effect the related changes in a pragmatic and efficient manner. Capitalized terms used in this letter and not specifically defined have the meaning given to them in the Request for Comment.

TMX

TMX is an integrated, multi-asset class exchange group. TMX's key subsidiaries operate cash and derivatives markets for multiple asset classes, including equities and fixed income, and provide clearing facilities, data driven solutions and other services to domestic and global financial and energy markets. Toronto Stock Exchange ("**TSX**"), TSX Venture Exchange ("**TSXV**"), Alpha Exchange, The Canadian Depository for Securities ("**CDS**"), Montreal Exchange, Canadian Derivatives Clearing Corporation, Shorcan Brokers Limited and other TMX companies provide securities listing markets, trading markets, clearing facilities, data products and other services to the global financial community and play a central role in Canadian capital and financial markets.

I. Executive Summary

Concerns regarding short selling in the Canadian market have been raised, particularly that some market participants may, solely as a means to drive down the price of an issuer's securities, engage in short selling where they enter short sale orders without an intention to settle the resulting trades on the settlement date. We share the related concern of CIRO and the Canadian Securities Administrators ("**CSA**") that the current voluntary buy-in procedures in Canada are too lax and could contribute to a negative perception of capital markets in Canada. Additionally, liquidity providers and global asset managers have noted a lack of discipline around failures to deliver securities in the Canadian market, leading to increased funding costs and wider spreads. Effecting mandatory buy-in requirements and reducing the failure-to-deliver rate could increase investor confidence and improve the perception of Canadian markets.

As such, CIRO is proposing to introduce a mandatory close-out requirement that would require IDM CDS Participants (as defined below) that are unable to deliver sufficient shares on settlement date to CDS to close out that position within set timelines. The IDM CDS Participants would be required to close out a fail-to-deliver position by either purchasing or borrowing shares, or allocating all or a portion of the fail-to-deliver position to another Investment Dealer Member for which it clears or settles trades.

We support CIRO's actions to bring forward proposed requirements that may address Canadian stakeholder concerns about short selling and that will better align Canadian close-out practices with global standards. A Canadian rule that is similar to Regulation SHO in the U.S. should have the beneficial effect of reducing failures to deliver in the Canadian market. However, we expect that the Proposal will have material impacts on Investment Dealer Members and on the subset of CDS Participants that are Investment Dealer Members ("**IDM CDS Participants**"), with potential cascading effects on securities lending and borrowing.

While we support better controls around failed trades, we urge CIRO and the CSA to extend the proposed implementation timeline of any new requirements in order to hold additional granular discussions with a broad group of stakeholders to explore the kinds of compliance solutions that could be built most efficiently to address the concerns mentioned in the Request for Comment. Solutions designed with broad industry-wide contributions could enable the requirements proposed in the Request for Comment to be complied with, without negative unintended consequences.

Our analysis below covers important topics to be considered as the requirements under the Proposal are further refined, including: the current buy-in process in Canada; uneven application of requirements on CDS Participants; distinctions between the Proposal and Regulation SHO and their impact on stakeholder readiness; unknown impacts of the Proposal; and appropriate exemptions to be considered for persons with Marketplace Trading Obligations ("**MTO**"). Furthermore, we provide responses to specific questions raised in the Request for Comment to further inform such refinements to the Proposal. We hope our analysis is helpful and look forward to collaborating with CIRO and industry participants on future steps to establish a mandatory close-out regime in Canada.

II. Current Canadian Buy-In Process

Currently, buy-ins in CDS are, in fact, low volume, and have remained a predominately manual process to this point. By way of further context, CDS, through the respective buy-in procedures of applicable listing venues, facilitates a voluntary process whereby a CDS Participant that has not received a listed security for which it has paid can give notice to the CDS Participant that has failed to deliver, to initiate a buy-in process. For TSX- and TSXV- listed securities, for example, a buy-in procedure is followed based on a list received from CDS, which facilitates an opportunity for a CDS Participant to receive the security, while the trader selling into the buy-in receives a premium over the security's price. The CDS Participant that failed-to-deliver is charged the premium. Information related to the TMX buy-in process may be instructive to the analysis of the Request for Comment. For example:

- Notice to buy-in is given 48 hours prior to the buy-in day. For a security that was scheduled to settle on T+1, the buy-in cannot take place until T+3 at the earliest.
- A preliminary buy-in list is posted at 12:30 p.m.; a final buy-in list is posted at 2:45 p.m.
    - It is typical that a large majority of securities listed on the preliminary buy-in list are removed by the time the final buy-in list is posted.
- All TSX and TSXV Participants are permitted to use the TMX buy-in procedure for TSX- and TSXV- listed securities.
    - CDS Participants that are not Investment Dealer Members can also avail themselves of this voluntary process to obtain securities that are owed to them.

We can take from this information that CDS Participants who have failed to deliver securities are accustomed to operating under the manually intensive, long-established and well known CDS buy-in process, which provides a 48 hour notice period from the buyer before a buy-in process is initiated. This data point may be relevant when assessing the Proposal's requirement to close out a fail-to-deliver position no later than T+2. In addition, we note that on the buy-in day itself (T+3), the preliminary buy-in list is much longer than the final buy-in list. Knowing that the buy-in list can decrease considerably within a few hours on T+3 indicates that the current buy-in volumes for

TSX- and TSXV- listed securities cannot be taken as a proxy for estimating the volume of fail-to-deliver securities under the Proposal's requirements.

Finally, there is the knowledge that CDS Participants that are not CIRO members currently avail themselves of the voluntary buy-in process. TMX expects that when the Proposal comes into effect, the CDS voluntary buy-in procedures would no longer be required; however, it is unclear how CDS Participants that are not Investment Dealer Members may be impacted if the Proposal becomes effective and the CDS buy-in process ceases.

III. Application of the Proposal

The Request for Comment acknowledges that there are CDS Participants that are not Investment Dealer Members. Therefore, CIRO's requirements for mandatory close-out would not apply to all CDS Participants. The question about the possibility of regulatory arbitrage across CDS Participants was raised in the Request for Comment.

Securities that are listed by a Canadian exchange and traded on a Canadian marketplace are submitted to be cleared and subsequently settled by an IDM CDS Participant. A TSX- or TSXV-Participating Organization cannot give up its trades on a marketplace for clearing to a CDS Participant unless it is an IDM CDS Participant. Therefore, the on-marketplace trading regulated by CIRO results in trades that are submitted to be cleared and delivered to be settled by CIRO-regulated entities (i.e. IDM CDS Participants). From this perspective, regulatory arbitrage may not be a significant concern to the Proposal with respect to trades that occur on a marketplace.

However, CDS Participants that are not Investment Dealer Members certainly could hold Canadian publicly listed securities in their accounts, and therefore the application of the Proposal's requirements could result in unequal treatment of one class of CDS Participants versus another. Further details are needed in order for the industry to determine the impact of the imbalance that comes with a requirement that would only apply to a subset of CDS Participants. In order to assess impact, the final requirements should provide more granular detail in order to clarify the definition of a fail-to-deliver (i.e., what time of day is this determined) and to clarify how "fails" from administrative delays (such as inter-account movements of securities) are treated.

TMX agrees with CIRO that a requirement for mandatory close-out should, as with Regulation SHO, apply to clearing house participants and should be focused on failures at settlement. We agree that the alternative that was discussed and rejected in the Request for Comment (i.e. mandatory close-out requirements as a conduct rule) is not appropriate as it would require the IDM CDS Participant to close-out each individual failed trade as executed on a marketplace, regardless of whether this results in a settlement failure at the clearing agency.

IV. Industry Impact & Considerations

A. IDM CDS Participant Readiness

While the requirements in the Proposal may align conceptually with Regulation SHO, the Proposal's outcome, in terms of operational changes and related impacts on Canadian market participants, is much different than the impact on U.S. participants under Regulation SHO. It is our understanding that there are processes in place at the U.S. clearing agencies that assist participants with closing-out positions, whereby the infrastructure supports the concept. For example, the National Securities Clearing Corporation ("**NSCC**") offers a program that permits the NSCC to borrow securities from its participants for the purpose of completing settlements if the participants have made those securities available to NSCC for this purpose and those securities are on deposit in the participant's account at The Depository Trust Company.

By contrast, the operational effort to comply with the requirements in the Proposal will fall squarely on IDM CDS Participants. The IDM CDS Participants will be required to address the shortened period of time that will be available to close-out positions. To do so, IDM CDS Participants may have to enhance existing systems in order to map the continuous net settlement fails to client accounts, develop new systems and processes to accelerate securities borrowing logistics, and operationalize processes that ensure that positions are in fact closed-out in a compressed timeframe. Investment Dealer Members will need sufficient time to implement these compliance solutions.

B. Clearing

Many CDS Participants currently operate under Regulation SHO and are familiar with its requirements, understanding its inflexible nature regarding extended fails. Similarly, the Proposal would impact the flexibility and discretion afforded currently to IDM CDS Participants. By removing the existing flexibility, the impact will be that IDM CDS Participants will have additional and time-constrained processes to perform.

It should be noted that there seems to be little impact on CDS Custodians directly, however the impact and obligations will fall on clients of the custodians who fall within the purview of this Proposal. As a result, this client-custodian relationship may be beneficial, as many custodians possess agency lending capacity that can be leveraged for their clients.

Our clients have also advised us that securities lending/borrowing processes would need to take place earlier in the day, and more efficiently, than present market practices, to meet morning cutoffs. The impact on securities lending practices, particularly in morning windows, places an emphasis on improved processes and automation across the securities lending ecosystem. We urge CIRO to meet with industry constituents that have experience with Regulation SHO to further explore and clarify some of the potential outcomes of imposing a similar rule in Canada. An updated fails regime should complement buy-in and stock-borrow processes to improve settlement discipline, and we recommend that CIRO hold market-wide workshops with all affected industry players to ensure the pragmatic implementation of this regime. Our expectation based on feedback from our clients is that securities lending practices will be impacted, with increased borrower requests earlier in the day. While this will place pressure on associated settlements, we acknowledge that, ultimately, the Proposal should result in fewer settlement failures.

The Proposal may result in additional reporting requirements for CDS. Pursuant to CDS's mandate to consult and collaborate with our stakeholders, CDS will, in the normal course, engage with our industry and regulatory stakeholders to ensure appropriate analysis, development, and deployment of any such reporting requirements. Such engagement, including market and stakeholder workshops, would commence after the transition to the new CDSX (including the period of enhanced support).

C. Trading

The Proposal indicates that one way to close out a fail-to-deliver position is to purchase the security in the market, and a related question in the Proposal asks about factors or considerations to ensure that purchases are made in a manner that is consistent with market integrity. TMX agrees that these are the right questions to ask. Where fails-to-deliver occur in illiquid securities in particular, purchases to close-out a position could be made at unusual prices, and could set a last sale price or even a closing price on a marketplace. While transparency is generally beneficial, CIRO may need to be flexible in how these types of trades are permitted to take place, to ensure that overall market integrity is maintained.

Persons with Marketplace Trading Obligations

The Request for Comment provides that where a fail-to-deliver position is attributable to a transaction by a person with MTO when acting in their security of responsibility, the required date to close-out the fail-to-deliver position will be S+3. TMX agrees that additional time to close-out should be afforded to persons with MTO when acting in their securities of responsibility. Persons with MTO are performing transactions for the benefit of the market, and they are fulfilling liquidity needs in response to retail client demand. Persons with MTO when trading in their securities of responsibility are not taking actions that raise short selling concerns. Given that this category of market participants are performing activities that are designed to benefit the market, and are not performing activities that are related to the stakeholder concerns that are referenced in the Proposal, we urge CIRO to consider whether the settlement date for close-out should be extended for this category of market participant.

Further, as regards to odd lot trading by these persons, we suggest that CIRO should consider exempting these trades from mandatory close-out requirements. There may be regular occurrences where persons with MTO are required to fulfill client orders for illiquid securities. Where these trades are in odd lots, it could be extremely difficult for the person with MTO to close out the position. If the person with MTO is a key source of liquidity for the market, their ability to close-out the sale of an odd lot in an illiquid security could be extremely challenging, and warrant additional time. We expect that odd lots would be a fraction of the total volume of securities that would be captured under daily mandatory close-outs, so the impact to the objectives of the

Proposal would be negligible if an exemption was given to odd lot trades by persons with MTOs in their securities of responsibility.

V. Implementation Timelines

The requirements in the Proposal most directly and significantly impact Investment Dealer Members, in particular IDM CDS Participants. These market participants will, as previously noted, need sufficient time to develop compliance operations and processes in order to adhere to the requirements. We understand that the operations and processes that would need to be built for compliance with the Proposal's requirements would be unique to Canada (i.e., these operations and processes are not already in place for Regulation SHO purposes).

The Proposal expects that CDS would provide daily fail-to-deliver positions in each listed security to each IDM CDS Participant and to CIRO. CDS does not currently produce these lists. CDS anticipates that it would take at least 12 months from the time the requirements are finalized, to create a process whereby the lists are created and sent securely to the IDM CDS Participants and to CIRO. However, we understand from our clients that it could take longer for them to build their compliance solutions. We reiterate our recommendation that CIRO hold market workshops with affected industry players to develop, test, and implement solutions to ensure that the resulting compliance processes are coordinated, pragmatic, and efficient.

VI. Responses to Certain Questions

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 CIRO requirement that would only affect Investment Dealer Members that are within CIRO's jurisdiction.*

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

In this letter, we have confirmed that securities that are listed by a Canadian exchange and traded on a Canadian marketplace are submitted to be cleared by an IDM CDS Participant. A marketplace cannot give up its trades for clearing to a CDS Participant unless that CDS Participant is an IDM CDS Participant. While TMX does not have a view on whether the Proposal creates an incentive for Investment Dealer Members to seek entities not regulated by CIRO for clearing purposes, the mere fact that a consequence of the Proposal is that different categories of CDS Participants would be subject to different settlement standards raises the question of whether the CSA and CIRO believe that the segmented application of this requirement is fair.

However, the Proposal, if enacted, would force IDM CDS Participants to dedicate resources to build compliance processes to address the Proposal's requirements, while other CDS Participants would not be subject to a mandatory close-out rule. This could be viewed as an unfair regulatory burden being placed on one category of clearing participant. The Proposal, if enacted, would result in an uneven playing field for different categories of CDS Participants. TMX submits that it is important for CIRO with the CSA to consider whether the benefits that would arise from the Proposal are sufficient to create an uneven playing field.

***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?

We believe that there is value in having these trades occur on a marketplace. The transparency would be beneficial to the market. TMX acknowledges that there could be potential market disruptions that would need to be monitored.

***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?*

Canada should follow Regulation SHO in this regard. Consistency with the U.S. is beneficial to Canadian markets. Investment Dealer Members that have not closed out fail-to-deliver positions should be able to continue short selling as long as they pre-borrow for themselves or their clients. A dealer's failure-to-deliver may be connected to one client in particular, and to restrict short-selling for other clients could have the effect of penalizing these other clients.

***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.*

If the Proposal proceeds as published, feedback received from our clients is that they would need at least 12 months to build compliance processes, from the time the final regulatory requirements are published. CDS would also recommend no less than 12 months for development of the fails lists and protocols to provide the lists to CDS Participants and to CIRO. Extensive work with the securities lending industry will be required to ensure that there is enough time to locate and facilitate borrows early each morning. We urge CIRO to engage with its Investment Dealer Members along with the broader industry, in particular the securities lending community, to understand the process changes that will need to be made. This could impact the effective date of the new requirements.

VII. Conclusion

Bringing mandatory buy-in requirements to Canada would more closely align our market with practices in global markets and increase confidence in our markets. Notably, for any short sellers entering orders on Canadian marketplaces without an intention to settle the resulting trades on the settlement date, then mandatory close-out requirements should make that activity untenable. TMX supports the implementation of a rule similar to Regulation SHO that would have the effect of reducing fails in Canada, with a consideration to extend the proposed implementation timeline to at least 1 year after the final requirements are published, to ensure the ecosystem can absorb the change.

While the Proposal is intended to place better controls around failed trades, we urge CIRO to consult with the broader industry to ensure that it has a comprehensive understanding of any unintended consequences. If the timeline is extended, this provides opportunity for market workshops and planning to ensure that market capability is able to meet the concepts of the Proposal. As designed, the Proposal would have the effect of imposing considerable new compliance operations on the CIRO members that are CDS Participants - in a manner that would have more of an impact on participants than Regulation SHO compliance operations. The Proposal would also meaningfully affect securities borrowing and lending practices. We urge CIRO to discuss this topic with industry experts to ensure that the transition to a mandatory close-out rule is done thoughtfully with ample time allotted to the market participants that will build compliance solutions.

We appreciate the opportunity to respond to the Request for Comment. We look forward to working collaboratively with CIRO and industry participants on steps related to enacting a mandatory close-out regime in Canada.

Sincerely,

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