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Via Email

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

We are writing on behalf of Scotia Capital Inc. and our two operating divisions, Global Banking and Markets and Global Wealth Management. We appreciate the opportunity to comment on the CIRO consultation regarding proposed amendments respecting mandatory close-out requirements in Canada (the "Proposal").

Global Banking and Markets (GBM) conducts the Bank's wholesale banking and capital markets business with corporate, government and institutional investor clients. Global Wealth Management (GWM) offers a full range of wealth management advice and solutions through its full-service brokerage and order execution platforms.

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## General Remarks

We commend the CSA and CRO for the long history of principles-based regulation in the area of short selling. We believe Canada's regulatory regime regarding short-selling is fundamentally sound, conforms with IOSCO principles in this area, and protects equity market investors. We believe that the Canadian framework strikes an appropriate balance between risk management and efficiency.

We acknowledge short-selling, and in particular "naked" short-selling, can present risks to the financial system by creating a greater possibility of unsettled trades (or "settlement fails") and we agree persistent settlement fails could negatively impact capital markets in Canada, including investor confidence in a fair and orderly market.

We note, however, CRO's 2022 Failed Trade Study cites low aggregate fail rates and does not draw a causative link to "naked" short-selling<sup>1</sup>. The Proposal indicates that roughly 1% of trades fail, and that only a percentage of these failed trades are related to short sale transactions.

This raises the question of whether there is a fundamental persistent settlement fail problem in Canada, and whether the Proposal's mandatory close-out or buy-in requirements be effective at addressing any real or perceived problems with the Canadian short-selling regime, including by meaningfully reducing the incidence of fails.

We do not believe that there is a systemic problem in Canada and therefore do not believe it is necessary or desirable to introduce a mandatory close-out (or buy-in) regime in the Canadian context. CRO's 2022 study supports our views. We would propose that prior to enacting significant market reforms, CRO conduct further study and analysis on this topic to establish whether the market and trading environment has significantly changed.<sup>2</sup> We do not believe that any major changes to the regime are required at this time and in advance of further study.

However, one thing is clear: additional requirements, including mandatory close-out, buy-in, "locate" or "pre-borrow" requirements (at the time of execution) would significantly increase execution costs for any participants in scope for the requirement, without producing an offsetting benefit. It would add

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<sup>1</sup> In the Study, the most cited reason for settlement failure (other than "other") is "counterparty short position" – which means that the party delivering the shares is unable to make delivery, not that the counterparty has a short position. This could occur in many circumstances involving long sales, particularly where the sold shares are lent out, posted to a third party as collateral, or where CNS has an overall short position for a clearing member.

<sup>2</sup> From a Canadian perspective, we do not believe mandatory close-out or buy-in requirements would be effective at addressing any perceived problems with the Canadian short-selling regime, or meaningfully reduce the incidence of fails. The biggest hurdle to such a regime is ensuring that a mandatory close-out settles. We believe that a purchase resulting from a mandatory buy-in to cover a short would be likely to fail. Such buy-ins would likely face intermediaries seeking to earn an arbitrage profit by selling at a premium to prevailing market prices and would be selling short – in an environment where settlement is difficult and borrow may be hard to access.

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administrative burden to the investment community, including the cost of adapting systems to comply with new requirements. We believe that the Canadian market structure is sufficiently different from that in the U.S. and that we should not harmonize for the sake of harmonization, or for the sake of addressing concerns lacking clear evidence.

While we support rulemaking efforts in this area in general, we do not support the approach in the Proposal. For your consideration, we set out (i) the Proposal's core challenges, (ii) an alternative path to achieving the policy goal of acting against persistent failed trades and, (iii) answers to the specific questions set out in the Proposal.

### **Core Challenges of the CIRO Proposal**

The approach in the CIRO Proposal introduces several core challenges:

- The Proposal only covers CIRO-regulated Investment Dealers and clearing firms, resulting in a two-tier rule structure where CIRO-member clearing firms ("Clearing Members") are subject to a higher standard with respect to mandatory close-out of failed trades. This matter is discussed further below.
- Trade settlement at Canadian Depository for Securities Limited and CDS Clearing and Depository Services Inc. ("CDS") occurs after the netting of transactions. Many transactions, in aggregate, result in a relatively small number of net settlements. This makes it impossible to definitively determine which specific transactions gave rise to the fail-to-deliver. In turn, this prevents (i) accurate allocation to other dealers who may be ultimately responsible for the fail-to-deliver and (ii) accurate and timely determination of the close-out deadline (long vs. short).
- While the Proposal is analogous to Regulation SHO Rule 204, implementation in Canada would be costly and complex. While some Canadian dealers operate U.S. clearing members, the systems and processes that interface with U.S. markets and comply with U.S. requirements are distinct and separate from Canadian operations. This means that there is limited means for leveraging existing processes to facilitate compliance with the Proposal's Canadian mandatory close-out provisions, and affected Investment Dealer Members would incur significant implementation costs.

### **A Targeted Approach**

We believe, where CIRO wishes to focus efforts on avoiding Canadian persistent settlement fails, a more appropriate approach to achieving CIRO's policy goal is to focus on the two areas which we believe may most frequently give rise to a dealer's fail-to-deliver in the Canadian context: (i) owed

positions from delivery-versus-payment (“DVP”) trades, and (ii) changes in positions within a dealer’s own accounts.

In both cases, a tailored approach is required to achieve CIRO’s policy goals. As well, in all cases, the rules must apply to all market participants.

### **Delivery-Versus-Payment Settlement Process**

Our experience suggests that a significant portion of overall fail-to-deliver situations are triggered by a DVP client’s failure to deliver a position which has been sold by that client. This can result from numerous operational considerations, such as the shares being lent out to other investors, or used in financing transactions as collateral. Introducing greater rigor to the DVP settlement process (for all parties) would, in our view, greatly reduce fail rates. Crucially, it would allow targeted intervention to the source of fails, instead of the complex, burdensome and expensive close-out regime set out in the Proposal.

For DVP fail-to-deliver situations, our suggested approach is two-fold:

- Require dealers owing securities in a DVP settlement to establish policies & procedures reasonably designed to ensure that securities are in position to be delivered on settlement date, including through recall of lent securities and other operational means.
- Require dealers owed securities to similarly establish policies & procedures which would culminate in a timely buy-in of a failing DVP position, including automatic issuance of buy-in notices.

We believe one key positive consequence of this approach would be its universality: expectation of settlement does not depend on Continuous Net Settlement (“CNS”) status, and whether a security is ultimately owed to CNS. In a situation where a client is failing to a DVP transaction, but the dealer is a net purchaser that day, the onus remains on the failing client. There is no relief to the client from the happenstance that a dealer is not in a failing position.

### **Ensuring Settlement Within a Dealer’s Accounts**

In relation to settlement fails within a dealer’s own accounts, a similar approach is appropriate. However, the focus of policies & procedures should be on ensuring that the dealer’s securities borrowing activities correspond to the increase in net short position within the firm. For instance, if the firm’s own positions (held for clients or for inventory) becomes “more short”, procedures should exist

to ensure that such shares are borrowed in a timely fashion, ensuring that no subsequent fail-to-deliver to the central depository (or clearing member) occurs. If shares cannot be borrowed, then dealers should have procedures for timely repurchase.

### **Broad Solution Applied to Narrow Participant Group**

If mandatory buy-ins are deemed to be essential, we believe that the rules must apply to all market participants. As outlined above, and in greater detail in the answers to the Proposal's questions below, a significant portion of failed trades result from DVP transactions with non-CIRO institutional custodians. As the custodian is not exposed to the CIRO requirement, a CIRO Investment Dealer Member would be required to borrow or buy-in at their own expense. In addition, the Proposal would require costly technology and supervision enhancements from CIRO Investment Dealer Members, while non-dealers would remain unaffected. We believe these factors will encourage regulatory arbitrage and will erode the effectiveness of these rules over time.

As noted in the Proposal, other jurisdictions such as the US and Australia impose buy-in requirements at the clearing and settlement facility level, rather than on a sub-set of market participants directly. This distinction would make Canada unique in introducing a two-tier structure to mandatory close-out of failed trades. If the Proposal were to go ahead as drafted, we believe that Canada should put the global precedent into practice with the rules being administered by CDS and not CIRO.

### **Answers to the Proposal's Specific 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?*

The risk of regulatory arbitrage is material.

While most equities trading in Canada currently occurs through Investment Dealer Members, we note that all Big Six<sup>3</sup> bank-owned dealer members are also affiliated with a non-dealer CDS clearing firm. If a costly and burdensome requirement is imposed on only Investment Dealer Members, but not on affiliated CDS clearing firms, an economic incentive is created to shift the Investment Dealer Member from a self-clearing model to one that clears through an affiliated clearer subject to less stringent rules.

While this practice does not occur today, we believe that the introduction of CIRO-specific clearing rules would incentivize this outcome. Therefore, we believe any provisions related to mandatory close-out by the CIRO Clearing Member should be applied universally, across all clearing members, and not only those which are also members of CIRO.

Even if no regulatory arbitrage occurs in practice, CIRO's proposed outcome does not uniformly apply to all relevant parties. In the event of fails resulting from DVP transactions where securities have not been delivered to a Clearing Member, the failing counterparty may not, in turn, be an Investment Dealer Member. In this case the Clearing Member is unable to allocate the fail to the responsible party, as that party is not a CIRO Investment Dealer Member, and would instead be responsible for meeting the stipulated timelines for close-out at the clearing member's cost.

Since a significant portion of DVP transactions face custodial banks and other non-Investment Dealer Member CDS members, CIRO would, under the Proposal, have no recourse to apply the mandatory close-out provision to those parties. This unfairly burdens CIRO members for covering the costs of close-out for transactions where the origin of the fail is outside their control.

*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*

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<sup>3</sup> Bank of Nova Scotia, Royal Bank of Canada, Toronto-Dominion Bank, Bank of Montreal, Canadian Imperial Bank of Commerce, and National Bank of Canada

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We do not believe any dealer in Canada currently has the books and records in place to accurately perform this determination in a timely manner pursuant to the proposed timelines. The practice of aggregation and netting of trades prevents the easy determination of which underlying transaction resulted in a fail-to-deliver.

The core challenge with this requirement is the lack of one-to-one correspondence between a trade in the market (including order designation as long, short or SME) and the CNS outcome (including failing to deliver). Industry practice is to aggregate and compress transactions in the market to the total amount purchased or sold by a dealer, with no regard for whether the original order marking was long, short or SME. All purchases and all sales are aggregated by the dealer, matched to CDS records (by CDS), and the difference between the security & cash balances is settled.

The aggregation and netting of trades prevents the unique reverse-engineering of which underlying transaction resulted in a fail-to-deliver. For example, if on a given day a dealer executed 30 individual purchases for a total of 30,000 shares, and 50 individual sales for a total of 50,000 shares, all of which were agency transactions against DVP customers, the net liability to CDS is to deliver 20,000 shares. If 1000 shares of the 20,000-share liability is failing to deliver to CDS, there are 50 potential market sales which could be responsible, with some of those 50 covered by the 30 individual purchases.

Dealers could have significant discretion in how they choose to make these allocations, including by assigning fails to CDS to long sales in the interest of a more permissive close-out deadline.

Further, while we believe dealers have the underlying data (individual executions, client orders, settlement instructions to CDS), these data elements are generally held and managed in separate systems which interconnect based on the stage of each trade's lifecycle. We do not believe any dealer currently has the systems in place to combine this data in a manner which would permit the determination described above, or to allocate responsibility for fails to other investment dealer members.

Preliminary exploration of the feasibility of building such systems indicates a significant cost and implementation time burden. In the absence of very detailed analysis, we estimate that a project to develop systems that accurately determine close-out deadlines based on market executions (long, short, SME in security of responsibility), allow for allocation to other investment dealer members, facilitate failure notice and buy-in notifications, and implement a mandatory buy-in would require a time frame of no less than 18-24 months to implement, at a significant cost. We are prepared to discuss this preliminary analysis with CIRO if requested.

*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?*

We do not believe the means to allocate a portion of a fail-to-deliver position to another Investment Dealer Member currently exist within Clearing or Allocated Members.

We note that the original driver for this initiative, the 2021 Capital Markets Modernization Taskforce report, recommended S+2 buy-in specific to short-sales, in a T+2 environment. We feel this analysis correctly identified the significant administration associated with a mandatory buy-in regime. The move to T+1 settlement magnifies all settlement challenges by reducing the amount of time in which processes for fail-to-deliver allocation can run, notifications can be made, and corrective actions taken.

Notwithstanding the shortened T+1 settlement, we do not believe the means to robustly allocate a portion of a fail-to-deliver position to another Investment Dealer Member currently exist. As noted above (Question 1), the systems necessary for systematically (and quickly) tracing a specific CNS fail-to-deliver for the purpose of assignment would need to be developed.

This challenge is magnified by the fact that a fail-to-deliver situation may have multiple ultimate responsible parties, with multiple dealers subsequently needing to make a determination of whom to allocate the fail to for close-out purposes. For example, a failing dealer may be owed shares by a DVP customer's custodian, whose position in turn is lent to a third party who may be late in returning recalled shares. In this case, allocation needs to span three separate firms, some of whom may not be CIRO members and therefore not under the jurisdiction of the proposed rule.

Further, consider the following example: on a given trading day a dealer purchases into inventory shares from a DVP making a long sale, while a separate and independent account executes a short sale of the same quantity into the broader market. At settlement, the dealer would deliver the shares they purchased to CNS. However, if the DVP customer fails to deliver, the dealer's obligation to CNS is to close-out by S+1 (short sale), while their allocation of the fail-to-deliver would be to a long seller with responsibility to close-out by S+3. This leaves the dealer with no recourse, as their close-out cannot be met on the timelines stipulated.

While we note that Regulation SHO Rule 204 incorporates a similar "allocation" provision, our understanding is that this provision is not universally applied, and instead the added cost of close-out is frequently absorbed by the dealer community and passed along to investors. It is unclear whether such costs are relatively limited in the U.S. market by virtue of its size and scope, and whether a similar cost

burden for Canadian dealers would become a significant competitiveness issue, particularly between self-clearing and outsourced-clearing investment dealers.

*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?*

We believe that in the presence of a mandatory close-out regime with shortened timelines, the existing extended failed trade reporting (“EFTR”) rules lose relevance and should be replaced with reporting appropriate to the close-out regime. For instance, EFTR could be replaced with a regime that focuses on failure to close-out positions such as those introduced in section 2.4.2 of the Proposal. The principal merit of retaining the EFTR regime would be to track and address administrative-delay issues such as “deemed to own” scenarios and other exceptional cases.

We note that the decision to retain or remove EFTR should be guided by the prevalence of extended failed trades in Canada. The 2022 Failed Trade Study suggests that extended failed trades are exceedingly rare, and therefore the marginal benefit of retaining these rules may not justify the administrative costs involved.

*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. The lack of uniformity in the proposed framework, due to its limitation to CNS fails by CIRO members, precludes a consistent application of close-out requirements.

Further, as noted above, the systems for accurate allocation of fail-to-deliver responsibility do not currently exist. Further, allocation is limited to CIRO Investment Dealer Members, leaving the possibility of non-CIRO member firms failing to deliver on DVP transactions unaddressed.

*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 buy-in transactions should be executed using normal open market facilities to the extent possible. In a T+1 trading environment, normal course purchases are expected to settle on the following business day, and all participants are required to act with a reasonable expectation to settle trades. Therefore, we do not believe it is necessary to specifically introduce off-market exemptions or facilities purely for the purpose of buy-in handling. In all cases, we believe that buy-in transactions should be publicly reported.

We note that a buy-in is typically a last resort for closing out a fail-to-deliver. A more economical approach is typically for the failing party to borrow shares. In circumstances where borrow is unavailable, buy-in processes also have no certainty of settling and may simply result in further fail-to-deliver situations among other dealers. Executing buy-in transactions at a premium to prevailing market prices, with no assurance that the buy-in settles, does not support market integrity and may instead harm confidence in the market.

*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.*

A buy-in specific regulatory marker would require a robust definition of its usage circumstance. It is unclear whether a marker would provide meaningful insight unless the buy-in was attributed with the LEI of the failing party.

For example, DVP clients who are failing to deliver for administrative reasons may choose to purchase shares to close out their own fail, including of a long sale. This would not typically be considered a “buy-in” but nonetheless arises from a fail-to-deliver situation. On the other hand, a dealer- or CDS-driven mandatory buy-in of an otherwise-unwilling participant would likely merit disclosure. However, it is unclear whether a marker alone would provide meaningful insight unless the buy-in was attributed with the LEI of the failing party. Since fail-to-deliver as currently defined in the Proposal relates to the obligations of a Clearing Member, rather than one of their clients (including DVP clients), a buy-in is a

netted result which may not be attributable to any single party and their LEI. We therefore question what would be achieved by introducing such a marker.

*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?*

Currently, in the event of a fail-to-deliver, participants will attempt to borrow the security and are generally successful in this. In most cases this results in securities being delivered before they would arrive had they been bought in. By forcing close-outs, the rules will be undermining the collective expertise of Street service providers (specifically in the securities lending areas of dealers and custodians) who could otherwise more swiftly resolve the fail in a manner that is less disruptive to the Canadian marketplace.

*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?*

Any measure which introduces additional steps to tracing a fail-to-deliver to its original source will hamper the ability of Investment Dealer Members to accurately allocate responsibility for fails or determine close-out timing. However, the mere use of average price or accumulation accounts would be unlikely to be the main driver of close-out challenges.

*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?*

Yes. The systems to link a CNS fail-to-deliver to individual trades do not currently exist. As discussed above, such systems would not be able to uniquely identify which specific trades result in a fail-to-deliver, as CNS is fundamentally netted. This limitation extends to identifying whether a particular SME-marked sale relates to a person with a Marketplace Trading Obligation acting in their security of responsibility.

We wish to highlight that a significant portion of beneficial and market-integrity-supportive SME activity occurs outside of the narrow confines of participants with Marketplace Trading Obligations. By limiting exemptions for SME activity to MTO in specific securities of responsibility, the proposed rule

would penalize participants who contribute to market liquidity voluntarily, and outside of the specific transactional marketplace programmes in existence today.

Within the proposed framework, we believe that all SME activity should be subject to an S+3 close-out timeframe. By confining most SME activity to S+1 close-out timeframe, CIRO effectively puts SME activity on par with short sales. On the other hand, the very definition of SME suggests that such activity is not bona-fide short selling, and therefore should not be treated as such.

Finally, this proposed shortened timeline for general SME activity is inconsistent with CIRO's recently published "Guidance on UMIR Requirements Related to Short Selling and Failed Trades" (GN-URPart3-24-0002), where Section 4.6 indicates:

*Proper use of the short-marking exempt order marker, including by entities with Marketplace Trading Obligations trading in their securities of responsibility, would indicate there is a reasonable expectation to settle.*

This indicates presumed ability to settle trades by compliant SME users, on par with long sellers who are expecting that shares they own can be delivered on a long sale. We therefore believe it is appropriate for short-marking exempt accounts and participants to be subject to S+3 close-out requirements.

*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.*

We refer CIRO to discussions of these challenges elsewhere in this submission.

Fundamentally, this requirement would necessitate a significant and costly infrastructure investment for the purpose of determining allocations. This is not easily done, since a single fail-to-deliver may have multiple contributing upstream fails-to-deliver from other parties, some of whom may not be Investment Dealer Members and therefore not subject to the rules. Dealers would be required to determine the upstream cause, where currently there is no visibility, particularly related to CNS fails, until a buy-in notice is issued.

Further, even if a dealer has line-of-sight into the reason of a specific (netted) fail-to-deliver from DVP customers, there could be significant leeway in how allocation is performed, including the potential for uneven treatment of counterparties. For instance, if a single CNS fail could be attributed to two upstream fails-to-deliver, one from a CIRO Investment Dealer Member and one from a non-CIRO CDS

member, a dealer may be economically incentivized to allocate the fail to a CIRO member, whereas in fact the non-CIRO fail is the more significant contributor to the fail-to-deliver.

*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?*

We believe that deemed-to-own circumstances typically arise from complex circumstances with operational challenges and severe administrative issues. These situations require case-by-case handling where a single timeline (such as T+35) is not generally appropriate. In some circumstances, T+35 would be too long, while in others it may require further accommodation.

We recommend that deemed-to-own exemptions from standard close-out timelines should be subject to a separate approval process with CIRO, without specific codified deadlines.

*Question 11 Are there other situations that would warrant an extended close-out timeline, and if so, what other exceptions should we consider?*

We believe it is important to provide exemptions or extensions, similar to “deemed to own,” for transactions in open-ended exchange-traded funds where the primary market process for a fund precludes primary market subscriptions on the same day as a secondary market transaction. This is commonplace for internationally exposed funds (T-1 instructions on primary market subscriptions), certain deposit-linked ETFs (no subscriptions on certain days due to banking constraints), and most FX-hedged ETFs (cut-off times on subscriptions). At times, primary market restrictions may span multiple days, typically due to foreign trading holidays. These restrictions are critical to ongoing investor protection of unitholders of ETFs, and we believe this practice is appropriate and unlikely to change.

In these circumstances, dealers facilitating ETF transactions may be acting in the interest of market integrity by making sales to investors in the expectation of being able to subscribe to new shares on the following business day. This may result in a one-day settlement delay in CNS, with no harm to the purchasing investor, to other investors in the fund, or to the public at large.

If mandatory close-out requirements introduce a risk that ETF market making firms are at risk of buy-in (at commercially unfavourable terms), we believe provision of liquidity to the ETF market will suffer, with direct harm to investors in Canadian ETFs. We therefore believe that limitations on primary market transactions should give rise to corresponding relief in mandatory close-out provisions. We recommend that CIRO adopt a policies & procedures approach to affirm that dealers active in the ETF market operate in a responsible manner in this regard, as we believe is the case today.

*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?*

The ability to continue to accept short sale orders where a fail-to-deliver has occurred is important given the complexity of the settlement process outlined in our previous responses. Dealers may have little or no recourse within the proposed timeframes, and as such, the imposition of a ban on accepting additional short sale orders may unduly impact investors and the dealers' operations.

*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?*

Mandatory close-out rules should be universally applied to all dealers, preventing an uneven playing field or regulatory arbitrage. We support the harmonization of rules across IDPC Rules and UMIR. If separate requirements are present in UMIR and IDPC Rules for technical or administrative reasons, we recommend they be entirely consistent.

*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.*

We believe CIRO's impact assessment correctly identifies that these proposed changes introduce significant implementation effort. However, we disagree with CIRO's view that impact would be greater to those firms which have experienced a higher rate of settlement failure. The Proposal applies to all Clearing Members, with a requirement to establish systems, policies & procedures for the purpose of compliance, irrespective of the historical rate of settlement failure. This would, on a relative basis, disproportionately burden dealers who experience a low settlement failure rate. This could further disproportionately affect smaller firms whose technology resources may not support the effort involved in building comprehensive systems for the purpose of compliance, but who also do not experience a high settlement failure rate.

*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.*

The qualitative assessment appears to be largely complete, however, as CIRO notes, is missing critical information on the costs associated with implementation. In addition to significant ongoing costs, our preliminary work effort estimates indicate one time implementation costs in the range of \$18-22mm. This estimate contemplates a system which links market trades with CNS failures, creates workflows to support buy-ins, and delivers notifications with sufficient automation to enable an S+1 buy-in process.

The Proposal indicates that roughly 1% of trades fail, and that only a percentage of these failed trades are related to short sale transactions. As stated previously, our experience shows that the bulk of failed trades originate with DVP settlement issues outside the control of the Clearing Member, which *could* benefit from enhanced policy and procedure requirements. We are not convinced that applying broad mandatory buy-in requirements to a narrow problem area will improve investor outcomes or reduce harm.

The Proposal also comes at a time when the country is seeing low productivity numbers while also managing a trade war with our largest partner. Implementing new onerous regulatory requirements ought to be done with the clearest of intentions to protect the Canadian investor.

*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.*

Given the scope of the proposed requirements, we believe a six-month implementation window is too short. Our estimates of effort, produced with only partial analysis of the work involved due to time constraints, suggest that the implementation of automated close-out/buy-in procedures would take 18-24 months. This estimate does not account for the effort required to scope, design, implement and deploy mechanisms to accurately allocate fail-to-deliver responsibility to other parties. We therefore recommend a longer timeline, potentially up to 24 months, to account for the complexity of the undertaking.

On the other hand, we believe a tailored approach focused on suitable policies & procedures designed to remedy the root cause of settlement fail-to-deliver situations may be implementable in a shorter window of time, as the scope of work can be narrowed to specific areas of focus.

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We highlight that existing systems related to Regulation SHO Rule 204, which may be present within our organization's affiliates, are not generally suitable for compliance with Canadian rules. The underlying settlement depositories, books of record, order management systems, recordkeeping systems and operational processes are different from jurisdiction to jurisdiction. Even where comparable systems exist, a significant adaptation of processes is typically required. Further, variation between jurisdictions precludes an effective harmonization and sharing of infrastructure and may lead to compliance risks. For example, U.S.-based systems designed to address Regulation SHO Rule 204 would have no concept of the "SME" order designation, short-marking exempt accounts, or Canadian Marketplace Trading Obligations.

Thank you for the opportunity to comment on this important Proposal. We would welcome the opportunity to discuss these issues directly with CIRO.

Respectfully,

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