CIRO Consultation: Proposed Amendments Respecting Mandatory Close-Out Requirements

May 30, 2025

ASSOCIATION DES BANQUIERS CANADIENS
CANADIAN BANKERS ASSOCIATION

Submission to the Canadian Investment Regulatory Organization (**CIRO**)

The Canadian Bankers Association (**CBA**)[1] appreciates the opportunity to provide input on CIRO's *Proposed Amendments Respecting Mandatory Close-Out Requirements* (**Proposed Amendments**).

General Comments

In our view, the current close-out practice is appropriate and reflects the unique circumstances of the Canadian capital markets. Specifically, the flexibility in closing out trades allows clearing members to work with their counterparties and close out positions while balancing market impacts, such as price volatility and speed of closure of positions. The current requirement to obtain extension requests ensures that failures to settle are tracked and subject to oversight.

We would therefore echo a number of other commenters and encourage CIRO to conduct further study and analysis of perceived problems with the Canadian short-selling regime and failed trades prior to enacting significant market reforms.

Proceeding with the Proposed Amendments will require significant new systems and technology development, resulting in increased cost and time effort by impacted firms.[2] Given that the Proposed Amendments will impact processes at Investment Dealer Members and Clearing and Depository Services Inc. (**CDS**), additional testing will be required by all market participants to ensure that development incorporates all new requirements.

Regarding implementation of any reforms, we recommend that an industry-led working group be formed to travel together throughout the implementation timeline, similar to other recent industry changes such as CDS/TMX Post Trade Modernization initiative[3]. We also wish to emphasize that industry members' resources are stretched as multiple competing initiatives are underway by various regulators, including the CIRO Rule Consolidation Project and Total Cost Reporting. The resources involved in these types of projects are typically the same teams within organizations, creating a challenge in assigning adequate resources to meet a tight implementation. Recognizing the complexity involved in implementing these changes as well as the multiple industry initiatives currently underway, we recommend an implementation period of 24 months at a minimum.

[1] The Canadian Bankers Association is the voice of more than 60 domestic and foreign banks that help drive Canada's economic growth and prosperity. The CBA advocates for public policies that contribute to a sound, thriving banking system to ensure Canadians can succeed in their financial goals.
[2] For implementation cost estimates from individual firms, we refer you to the comment letter submitted by Scotia Capital Inc. (response to Question 15) and National Bank Financial Inc. (page 5).
[3] TMX CDS Modernizing the Post Trade Experience

Consultation Questions

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 Proposed Amendments primarily aim to address settlement fails within the CDS Continuous Net Settlement (**CNS**) service. The Proposed Amendments would leave open the possibility for regulatory arbitrage to occur, as our understanding is that CDS does not presently limit CNS participation exclusively to CIRO members. To mitigate this risk, CDS rules would also need to be updated to ensure that all CNS participants are subject to the same close-out requirements regardless of their CIRO membership status.

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**

While the books and records information may be available across different systems, significant development would be required by Clearing Members and Investment Dealers to identify the trades and implement the required reporting, tracking, allocation and close-out processes to meet the proposed timelines.

In particular, the ability to meet the proposed timelines would be contingent on the CNS fail-to-deliver position being identified and communicated to the Investment Dealer, similar to what is currently in place under Regulation SHO in the U.S., where the National Securities Clearing Corporation (**NSCC**) issues reports to each Member, including a report that shows each CNS position in each security due to settle on that settlement date.[4] A significant and very costly systems build would be required for the Investment Dealer to tie that information to the specific trade (given that fails are netted).

Where the CNS process fails to provide a report on fail-to-deliver positions, the Investment Dealer would be required to develop new processes and systems to track its own fail-to-deliver positions which would require resources to track, monitor, update and reconcile fail-to-deliver positions.

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 are supportive of providing Clearing Members with the option (but not requirement) to allocate all or a portion of the fail-to-deliver position to another Investment Dealer Member as this amendment aligns with existing U.S. regulations. The Proposed Amendments should clarify that Investment Dealer Members who are allocated fail-to-deliver positions are responsible for complying with close-out requirements (not the Clearing Members).

In addition, given the mandatory close-out requirement includes trades that are in continuous settlements and the need for Clearing Members to be able to identify the fail-to-deliver position to allocate to another Investment Dealer, it is important to note that without timely and detailed reporting from CDS, Clearing Members will face significant challenges meeting the allocation and closeout timelines. To support the decision to allocate, the report would need to be at a level of detail sufficient to enable the Clearing Member to easily identify amounts owing, to whom they are owed, and all relevant dates. CIRO should also confirm whether CNS close-outs would follow the current CNS timelines or whether there will be new proposed timelines.

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**

[4] NATIONAL SECURITIES CLEARING CORPORATION RULES & PROCEDURES, Rule 11 SEC.4.

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 are supportive of repealing the extended failed trade reporting. Given the proposed close-out requirements, the extended reporting requirement would be redundant.

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?**

The Proposed Amendments introduce the following notification requirements:

- Allocation reporting by a Clearing Member to CIRO each time an allocation is made
- Notification by a Clearing Member to clients that are Investment Dealer Members when they fail to close out on time, as well as to CIRO
- Notification by an Allocated Member to the Clearing Member as well as to CIRO
- Notification by a Clearing Member or Allocated Member to a Trading Dealer

Equivalent requirements to the proposed IDPC rule amendments 4784(2)(iv)-(v) (which require that a notification be sent to CIRO once an allocation is made) do not exist under U.S. regulation. The implementation of allocation reporting in Canada would lead to inconsistent regulatory regimes as well as increased implementation, development, and monitoring costs for Investment Dealer Members.

We are also concerned about the operational challenges regarding notification of failure to close-out solely to Investment Dealer Members, which will require additional system identifiers to be created to track clients of a Clearing Member which are Investment Dealer Members. Clearing Members may not receive notices of changes in regulatory membership status in real-time from their clients, leading to delays in the processing of notifications. In our view, a notification of a failure to close-out in the prescribed timeframe should be mandatory by Clearing Members to all clients if there is a clearing relationship with that client, given the implications of the mandatory close-out requirements to the client's security positions.

We support the proposed notifications by Allocated Members to Clearing Members, as well as notifications by Clearing Members or Allocated Members to a Trading Dealer. We note that there will be substantial system development effort and investment required in order to implement these notifications.

Overall, while we support notifications among the parties directly involved in a trade settlement and clearing, we do not support the new notifications to CIRO, which are proposed as a means of achieving regulatory surveillance. CDS. as the clearing agency in Canada, already collects data on failed trades, including the identity of the Clearing Member, details of the fail-to-deliver position (security and volume), and applicable trade dates and close-out dates. We believe that existing CIRO surveillance alerts are adequate and the new notification requirements would lead to costly implementation efforts, and ultimately duplicate reporting.

As an alternative to mandatory allocation reporting, we would be supportive of replicating the US model which requires fail-to-deliver allocation data to be provided to the regulator on request, including during examinations, an approach that would not require new or amended CIRO rules.

Finally, as noted in our response to Question 2 above, a key element of the process which CIRO has not clearly outlined in this proposal, is the way in which Investment Dealers would receive the list of fail-to-deliver positions in order to meet the prescribed timelines to close-out. If CDS provides this information to Investment Dealers, similar to the NSCC, the Investment Dealer would be able to act on the position in a timely manner. There is also clarification required regarding the time of day in which the report would be provided to Investment Dealers, which CIRO can consider aligning with the current timeframe by the NSCC to lessen the impact on Investment Dealers already subject to Regulation SHO.

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?

In our view, purchases made on a marketplace to close out a fail-to-deliver position should be executed using normal open market facilities to the extent possible and publicly reported. Because 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, it is not necessary to introduce off-marketplace exemptions.

From an electronic market-making perspective, firms that trade Canadian listed securities have marketplace obligations on many of those securities and thus manage a long/short risk book

ranging from large cap to very illiquid micro-cap securities. To maintain fair and orderly markets, it is important to balance urgency of close-out versus price impact to the marketplace. This is especially true for illiquid securities. We believe a clear "premium cap" in basis points needs to be communicated for closing out securities benchmarked to the previous day's closing price.

The Proposed Amendments should seek to balance the perceived benefits (namely market transparency and increased close-out speed) with potential impacts, including market volatility. The flexibility of the current Canadian system generates cooperation among Investment Dealer Members and generally avoids significant price fluctuations in the case of illiquid securities or where the trade volumes would lead to market price moves.

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.**

Firms execute trading across numerous accounts, order management systems, and desks, and it is not feasible to ensure all executions that cover fail-to-deliver positions are marked with a marker. Shorts that are failing to deliver could be unintentionally covered through regular course of trading and not be marked.

The systems and technology development effort for a non-essential marker is anticipated to be substantial, resulting in additional costs to dealers and requiring more than the 6-month implementation timeframe noted in the Proposed Amendments. By way of comparison, recent project work among industry participants on Legal Entity Identifier (**LEI**) indicators and Montreal Exchange updates would be approximately comparable in terms of investment size.

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?**

We are concerned about the lack of flexibility in the proposed mandatory close-out rule, particularly as it relates to illiquid securities where a forced buy-in would cause volatility, whereas in the current state there is some flexibility in covering these positions and therefore minimize market impacts.

   a) **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?**

The use of average price or accumulation accounts would hamper the ability of Investment Dealer Members to accurately allocate responsibility for fails to deliver, thereby impeding their ability to close out in a timely manner.

b) 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, in the following respects:

- **Illiquid ETFs or securities:** If the marker is being applied on trading strategies for illiquid Exchange Traded Funds (**ETFs**) or securities. In these cases, the lack of liquidity may result in difficulty closing out shorts S+1.

- **Tracking limitation:** As noted in our response to question 2 above, current systems cannot track failures to deliver to specific trades**.** This limitation makes it impossible to identify whether a particular SME-marked trade relates to a person with a Marketplace Trading Obligation acting in their security of responsibility.

In our view, all SME activity should be subject to a S+3 close-out requirement. By requiring most SME activity to comply with a S+1 timeframe, this activity is, in effect, being treated like short selling. The characteristics and purposes of SME activity distinguish it from typical, or bona-fide, short selling and it should not be treated as such.

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.

See our response to Question 5 above.

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 do not have a comment on this question.

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

Further CIRO guidance would be helpful related to administrative fails (e.g., those created by bookkeeping entries, depository movements and transfers).

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?

In our view, a compelling, evidence-based policy rationale has not been articulated to support creating a pre-borrow requirement.

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?

Further analysis is required depending on the structure of the final rule; however, we are supportive of one comprehensive set of requirements.

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.

The following areas would benefit from additional guidance/clarification from CIRO:

- What are the considerations if a firm closes out a short position, but is then forced to take on another short position through Marketplace Trading Obligations at the end of day, without sufficient time to close the new position?
- What are the considerations for Marketplace Trading Obligations on securities where the firm has failed to close out a short and cannot acquire a pre-borrow?
- We recommend forming an industry/CIRO-led solution to tracking the status of failed delivery and notifications
- This CIRO consultation did not consider the role of CDS, a key stakeholder in the process. As we have noted in our response to Question 2 above, Investment Dealers would be challenged with identification of failed trade through CDS/CNS and the consultation has not stated whether CDS would be making this information available

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.

We view the current Canadian capital markets regulation to be appropriate for addressing failure-to-close positions. The flexibility inherent in the voluntary buy-in framework has resulted in cooperation among market participants today, which mitigates unintended market volatility and other impacts.

Again, we encourage CIRO to conduct further study and analysis of perceived problems with the Canadian short-selling regime and failed trades prior to enacting reforms.

We are particularly concerned about, and do not support aspects of the Proposed Amendments which would impose requirements in excess of those currently in place under Regulation SHO as they will increase the implementation and on-going costs for dealers, result in duplicative and onerous notifications, and ultimately continue the existing regulatory misalignment. For example, the implementation of allocation reporting will result in incremental development cost and effort for the Canadian market only, as it is not required under U.S. regulations.

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.**

The Proposed Amendments will require significant systems and technology developments and updates to policies and procedures. We also note that technical and reporting development work will be required by Investment Dealer Members and CDS, and in turn, industry testing. As noted in our response to Question 2 above, the ability to meet the proposed timelines is contingent on the CNS fail-to-deliver position being identified and communicated to the Investment Dealer – absent reporting by CDS/CNS, dealers will be required to develop their own systems and processes to identify and track fail-to-deliver positions.

To ensure full compliance, we would strongly recommend an implementation period of no less than 24 months, to allow sufficient time for industry collaboration as well as budgeting, planning, testing, and implementation.