RE: PROPOSED AMENDMENTS REGARDING CLIENT DELIVERY EXPECTATIONS

July 3, 2026

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Submitted via E-Mail: tlam@ciro.ca

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Dear Ms. Lam:

RE: PROPOSED AMENDMENTS REGARDING CLIENT DELIVERY EXPECTATIONS ("REVISED PROPOSAL")

The Canadian Forum for Financial Markets (CFFiM)/Forum Canadien des Marchés Financiers (FCMFi) is dedicated to advancing proposals that foster healthy, competitive financial markets and a resilient Canadian economy.

CIRO has substantially revised its Initial Proposal, as described in this correspondence, and removed proposed the mandatory close-out and pre-borrow requirements. While this represents progress, further consideration is needed. The Revised Proposal partially addresses certain concerns raised regarding the Initial Proposal but leaves key foundational issues unaddressed.

CIRO's Impact Analysis states that most investment dealers already maintain escalation processes to identify and resolve client delivery failures, whether or not those failures result in a CDS settlement fail. CIRO has not demonstrated that existing dealer practices are deficient or that the Revised Proposal addresses a meaningful market harm. Where the Revised Proposal largely codifies current dealer practice, regulatory resources would be better directed to higher-priority initiatives. Alternatively, where the Revised Proposal imposes additional obligations, these require a clear evidence-based need and should reflect a reasonable system of supervision based on market realities.

EXECUTIVE SUMMARY

Regulators should show, at a minimum, that the conduct of concern exists at a meaningful scale, causes identifiable harm, with current inadequate rules and that the proposed intervention is proportionate to a clearly identified problem of scale, without burdening benign activity. The Revised Proposal continues to be unsupported by empirical evidence demonstrating the existence, scale, causes, or risks associated with client delivery failures that would justify additional regulatory intervention.

The Revised Proposal continues to impose principal-like obligations on CIRO investment dealers acting as agents where control, information and economic ownership sit with other parties. This creates a mismatch between CIRO dealer responsibilities and capabilities and how settlement risk arises and can be addressed in the Canadian market. Dealers are being asked to act on failures they did not cause and cannot fully control, shifting administration onto them rather than addressing the source of a significant identified problem, if any. Specific timelines and enforcement risk move the Revised Proposal away from a principle -based reasonably designed system of supervision. This requires disclosure of missing data and the application of a commercially reasonable efforts standard.

A. THE INITIAL PROPOSAL

CIRO's proposed amendments to the Universal Market Integrity Rules (UMIR) and Investment Dealer Partially Consolidated Rules (IDPC) would have required CIRO Investment Dealers to:

- Close out a fail-to-deliver position in the event of a settlement failure in a listed security at the recognized clearing agency by specified timelines by buying or borrowing shares.
- Pre-borrow the affected security where there has been a failure to close out by specified timelines for all future short sales in the security at issue.
- Provide certain reporting and notifications in connection with mandatory close-out requirements, and
- Have a reasonable expectation to settle on settlement date for Investment Dealer Members that are not Participants under UMIR (Proposed Amendments) (the "Prior Proposal").

The key rationale for the Prior Proposal is the Ontario Capital Markets Modernization Taskforce (Taskforce) Final Report issued in January 2021. The Final Report indicated that Ontario's short selling regime stands in contrast to other jurisdictions such as the U.S., where there are mandatory close-out provisions in place and proposed to structure mandatory close-out requirements to align with similar requirements under Rule 204 of Regulation of Short Sales (Regulation SHO) (the "Final Report")

The Initial Proposal has been subject to valid critique for lack of substantiating evidence of a material regulatory concern.

B. THE REVISED PROPOSAL

CIRO revised its Initial Proposal and proposed instead that:

i) Investment dealers have policies and procedures that are reasonably designed to detect and address failures to deliver by a client following the sale of a listed security that is neither held by or under the control of the investment dealer (e.g. using Delivery-Against-Payment (DAP) and Receipt-Against-Payment (RAP) accounts). This requirement would apply regardless of whether the client's failure to deliver results in a settlement failure at the Canadian Depository for Securities Limited and CDS Clearing and Depository Services Inc. (CDS).

ii) If the failure to deliver relates to a trade that is a short sale, the investment dealer would be required to commence action to address the client delivery failure within five business days following settlement date, unless the client is able to demonstrate they are 'deemed to own' the security.

iii) "Commencing Action" means one of the following:
   - Buy back shares on a marketplace under reasonable commercial terms.
   - Require the client to deliver borrowed shares to the investment dealer,
   - Loan the shares to the client, or
   - Borrow shares from a third party.

iv) If the client is 'deemed to own' the security, there is no requirement to 'take action' until all delivery restrictions are lifted and, in any event, no later than 35 calendar days following the trade date. Deemed to own is:

- Purchased or entered into an unconditional contract to purchase the security but has not yet received delivery of the security.
- Owns another security that is convertible or exchangeable into that security and has tendered such other security for conversion or exchange or has issued irrevocable instructions to convert or exchange such other security.
- Has an option to purchase the security and has exercised the option.
- Has a right or warrant to subscribe for the security and has exercised the right or warrant; or
- Has entered into a contract to purchase a security that trades on a when issued basis, and such contract is binding on both parties and subject only to the condition of issuance or distribution of the security.

C. THE PREMISES APPLIED

In assessing the Revised Proposal, the CFFiM applied the following premises:

i) Regulations must support all impacted registrants irrespective of scale.

ii) Compared to the United States, Canada has a larger number of illiquid securities. Canada's smaller market, with fewer large cap companies, makes Canadian stocks more vulnerable to volatility caused by improper short selling and failed trades. Yet, a mandatory regime only works with a sufficient borrow market and secondary-market liquidity, which may not be available for many Canadian smaller cap companies.

iii) Stocks settling from exchange trades are generally settled CDS through Continuous Net Settlement system ("CNS"). Canadian settlement through CDS is netted, and the dealer or carrying broker may not be able to identify with precision which client trade caused the fail, how a fail should be allocated across introducing firms or underlying accounts, or whether a specific short sale is the source of a delivery problem.

Netting of transactions is due to most clearing/carrying brokers utilizing a single CUID for their trades, but that CUID represents the clearing of trades from multiple entities. The current information provided from CDS does not assist with the tracking or the allocation of these fails. Because CNS nets all buys and sells in each security for each CDS participant, many transactions, in aggregate, result in a relatively small number of net settlements.

iv) The CIRO investment dealer may not control the client's custody, inventory, or settlement mechanics. For example, an institutional client may settle through a non-CIRO custodian or agent.

v) Unlike Canada, the United States has numerous clearing brokers and an array of introducing brokers/RIAs.[1] The US clearing market has DTCC, NSCC, and OCC (which accept Canadian equities as collateral) while Canada only has CDS as an integrated, clearing/settlement agency and depository. Although the large and fragmented nature of the US market may lead to a greater need to resolve credit problems, the same issues may not be as prominent in Canada. Canada has a centralized system through CDS and a small number of highly rated clearing firms. This makes it feasible for securities regulators to consider a failure-to-trade system based on a credit and risk framework, if warranted by publicly disclosed data.

vi) Canada's existing framework also differs materially from the circumstances in which Regulation SHO was adopted in the United States. Regulation SHO, adopted in 2004 and implemented in 2005, imposed locate and close-out requirements to address persistent failures to deliver and potentially abusive naked short selling; it was not simply the introduction of a new blanket ban on all short sales entered without prior borrow or settlement capability.[2] In Canada, by contrast, CDS and exchange rules already provide buy-in and other settlement-enforcement mechanisms for failed trades, and UMIR 3.3 now expressly prohibits the entry of a short sale order unless the participant or access person has, before order entry, a reasonable expectation that the trade will settle on settlement date.

vii) Canada's existing framework comprises of exchanges overseen by CIRO and the Canadian Securities Administrators (CSA). At the provincial level, CDS is regulated by Quebec's Autorité des Marchés financiers (AMF), the British Columbia Securities Commission (BCSC), and the Ontario Securities Commission (OSC). The Bank of Canada coordinates its oversight of CDS with these other regulators pursuant to a Memorandum of Understanding[3] In addition, CDS reports as required to the CSA.[4]

D. ASSESSMENT OF THE REVISED PROPOSAL

The Revised Proposal reduces pressure without eliminating it, or without addressing structural realities and mechanics outside a dealer's or investor's control. This is outlined below:

i) Foundational Issues Not Addressed

a) Lack of Supporting Data : Generally

No fail culture in Canada has been established. The IIROC 2022 Failed Trade Study , which was never updated, suggests that extended failed trades are exceedingly rare. Since the move to T+1, no data has been produced to determine whether a short selling problem exists in Canada and, if so, its scope.

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[1] The US clearing, settlement, depository, and as a result, collateral finance business, has entirely different software, systems processes, and collateralization requirements which are suited to the needs of its liquid securities markets.

[2] Regulation SHO — Pilot Program; Key Points About Regulation SHO

[3] https://www.bankofcanada.ca/2022/01/notice-memorandum-understanding-january-13-2022/

[4] Clearing and Settlement Systems - Bank of Canada

The result is that the Revised Proposal does provide an empirical record demonstrating that failed-delivery positions currently constitute a material market integrity or counterparty-risk problem warranting the proposed intervention. In particular, the Revised Proposal does not provide data on post-T+1 fail rates, fail volume or value, the proportion of delivery failures that mature into settlement failures at CDS, the rate at which such fails cure within specified timeframes, or the distribution of fails by duration, liquidity tier, security type, or counterparty category. It does not identify a benchmark fail rate or exposure level that would constitute a meaningful prudential or market integrity concern or quantify the frequency with which failed-delivery positions have resulted in actual credit losses. A complete evidentiary record would include an aging analysis of failed-delivery positions, loss-given-default and probability-of-default analysis by liquidity tier and counterparty type, and an assessment of whether any residual risk is concentrated in particular counterparties or securities.

b) Lack of Supporting Data: Timelines

The Revised Proposal preserves fixed timelines without supporting evidence, rather than replacing them with a risk-based framework. The timelines for closing out a fail-to-deliver position and related buy-in on either the Initial Proposal or the Revised Proposal are not based on any consideration of whether a given failure-to-deliver presents a risk to the counterparty or the markets generally. They should be informed by a credit analysis incorporating loss-given default, liquidity, aging, and counter-party risk.

c) Operations

Continuous Net Settlement: The Revised Proposal continues to assume a level of traceability that the CDS system does not naturally provide, risking new builds and costs.

Delivery vs. Payment (DVP) and Receipt vs. Payment (RAP): DVP and RAP by its nature involves securities and parties outside the dealer's control and timing frictions. Failures to deliver in DVP/RAP are often not driven by naked short selling or intentional settlement failures but market structure mechanics (For example: timing mismatches in institutional settlements).

d) Regulatory Arbitrage

The Revised Proposal continues to create asymmetry where the obligation to "commence action" sits with the dealer but the root cause and control may not. Clearing dealers could be forced to absorb administration without operational control over a failing party, providing incentive to reconfigure clearing relationships away from CIRO dealers. For example, fails can originate from non-dealer CDS participants, custodians or institutional investors operating through DVP/RAP models.

ii) Issues Partially Addressed

a) Reg SHO

The Revised Proposal is more flexible than the Initial Proposal, reducing, on a relative basis, the risk of crowded buy-ins, borrow scarcity and squeezes driven by regulatory compulsion rather than economics.

But, if dealers must invariably begin remedial action within five business days for short-sale-related delivery failures, and the practical remedial options are limited, then some version of the same pressure can still emerge, particularly where borrow supply is thin.

b) Securities Lending

Securities lending is often the mechanism through which delivery failures are prevented or resolved. In the event of a fail-to-deliver, participants will attempt to borrow the security and are generally successful in this.

The Revised Proposal is more compatible with the continued functioning of securities lending in certain respects. Notwithstanding, the lending chain, including securities' availability, may be outside dealer control. In addition, any rule that increases dealer-only urgency around curing delivery failures can still make securities lending more expensive and less flexible, reducing lending supply and market liquidity and tightening borrow demand in stressed names.

c) Illiquid Securities

Junior or illiquid listed securities often have thin quotations, little or no borrow availability, limited market-making depth, and greater sensitivity to forced covering activity.

The Revised Proposal helps but the five-business-day trigger to commence action on a short-sale-related client fail can still create pressure in names where, for example, borrowing may be unavailable, or dealer or client action can itself move the market. That is especially important in Canada, where the market structure for illiquid names is not as deep as the U.S. and where order-routing alternatives among multiple market makers are more limited.

d) Warrants, Options and Restricted Securities

The Revised Proposal reduces concern, but does not eliminate it, where the third-party timeline/delay is beyond 35 days and beyond dealer control.

e) Dual-listed Securities

Canadian dealers may face operational challenges in sourcing the security resulting from low queue positions. Dealers may be unable to close due to a lack of supply of an inter-listed security.

E. PROPOSED SOLUTIONS

The following solutions are proposed to the market realities described:

a) Gather and Report Missing Data

CIRO and the CSA should work with CDS and exchanges to improve transparency and attribution of fails before considering additional responsibilities on CIRO dealers.

Regulatory Changes

To address the perceived risks associated with failures to deliver, it is necessary for CDS and exchanges to collect and report data on failures to deliver, buy-ins, and short sales. They should provide at least a year of post T+1 data regarding buy ins, failures to deliver (FTD) and short sales which illustrate frequency, credit risk, and market conditions.

Similarly, the impact of 'reasonable expectation of settlement' should be measured, studied, and disclosed prior to any changes.

Ongoing Reporting

On an ongoing basis, at a minimum:

- Exchanges should be required to report to CIRO and the CSA on when and how frequently buy-ins occur and the identity of the parties that fail to deliver.
- CDS should provide relevant reporting files directly to participating firms in a timely and standardized manner. CDS should also provide greater transparency regarding removals from its provisional buy-in list, including the applicable reason, where operationally feasible and consistent with confidentiality requirements.
- On a monthly basis, CIRO should disclose an aggregate report of failed trades by its clearing or allocating members that were not closed out by S+3. If shares haven't been delivered by then, the failure may be more consequential and useful to report.

The aforementioned should be precede any further consideration of any Revised Proposal or its implementation.

b) Apply Reasonable Terms to Regulatory Obligations

Generally

The regulatory obligation should be one of reasonable design and supervision. The standard should be whether the dealer has established, maintained, and applied policies and procedures reasonably designed to detect, escalate, and address material client delivery failures in light of the dealer's business model and information reasonably available to the dealer.

A reasonable supervisory expectation must take into account whether the dealer has direct control over custody, inventory, and settlement mechanics. Whether a dealer can buy in, borrow, loan, or otherwise resolve a fail depends on market liquidity, borrow availability, and custody arrangements beyond the dealer's control.

If a dealer is required to buy in or borrow shares using its own capital, take market risks, incur borrowing costs, absorb operational expense, and potentially dispute recovery from the client afterward, the system has moved beyond supervision to mandatory risk adoption.

It is therefore reasonable for the dealer to maintain policies and procedures to monitor and escalate settlement performance without mandating prescriptive buy- ins or financing actions.

It is also therefore reasonable for the focus of policies & procedures to be on ensuring that the dealer's securities borrowing activities correspond to the increase in net short position within the firm. If the firm's own positions (held for clients or for inventory) becomes "shorter," procedures should 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.

In any scenario, flexibility and deference to the firm's professional judgement is needed in the approach to allocations, reasonable price, timelines, and buy-ins, which reflect the real risks posed by failures-to-deliver. Deference to the firm's professional judgment avoids market harms of invariable timelines, generally, and for matters outside the dealer's control.

Specific Commercially Reasonable Terms

Netting

A reasonable supervisory expectation of CIRO dealers must take netting into account. Any proposal should include an explicit safe harbour where multiple trades are netted, and the dealer cannot conclusively map a fail to an execution/investor.

In other words, CIRO should require a reasonable investigation but should not regulate around a level of precision the system does not provide.

Control

The practical reality is that institutional settlement chains involve parties outside the CIRO dealer's and investor's control. The CIRO dealer's policies and procedures should reflect this reality whereby the dealer's reasonable system of supervision is prompt follow up with third parties including, where applicable, investors, without forced buy back, borrow or loan within a defined period.

Inter listed Securities

Delivery to CDS should be an acceptable mechanism to close out inter-listed securities.

Immaterial Failures

Regulatory intervention should reflect demonstrated material risk. Where delivery failures are temporary, operational, or resolved through market mechanisms like securities lending, additional regulatory requirements impose (in)direct costs without increased investor protection.

The Revised Proposal still does not draw a distinction between failure-to-deliver positions that result from deliberate efforts, including circumvention of naked short-selling rules, and failure-to-deliver positions that are simply the result of errors or operational challenges. Action should be required for failures which are material or repeated in the dealer's professional judgment. The exclusion of administrative, corporation action and timing delays where dealer has evidence that delivery is being worked toward can be more explicit.

A Commercially Reasonable Efforts Standard

A commercially reasonable efforts standard can address netting, control, inter-listed securities, immaterial failures, market conditions, and allocations.

Rather than defined periods, a commercially reasonable efforts standard, for example, can apply to account for a thinly traded security, unavailable borrows, actions that destabilize the market and bona fide market making.

As currently drafted, where the commencement of an action within the prescribed period is not reasonably practicable due to liquidity, borrow availability, transfer restrictions or other circumstances beyond the dealer's control, the dealer should proceed as soon as reasonably practicable. "Commencing action" should not require the dealer to complete the remediation within the same period where the completion depends on external third parties and commercially unreasonable market conditions, as determined by the dealer.

Clearing CIRO dealers should also be able to allocate all or a portion of the fail-to-deliver position to another firm as long as that allocation is made in a reasonable and timely manner.

CONCLUSION

The Revised Proposal continues to proceed from an unproven premise. CIRO has not demonstrated that delivery failures, which can arise from a broad range of non-abusive operational causes, constitute a systemic or material market integrity problem in Canada requiring new regulatory intervention. Before imposing any new rules on CIRO dealers, CIRO needs to show the scale, persistence, and nature of the non-compliant conduct it seeks to address, distinguish abusive activity from ordinary operational frictions, and show existing rules to be insufficient.

In addition, obligations imposed on CIRO dealers should reflect matters within their control, market realities, and commercially reasonable terms.

Should the data prove intervention necessary, reforms are better placed toward a market-wide settlement discipline.

Respectfully submitted,

Canadian Forum for Financial Markets

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cc.

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SCHEDULE A

Question 1 - In addition to the actions set out in section 2.3 of this Bulletin, are there any other steps that we should consider that an investment dealer should take when a client has failed to deliver shares as expected?

Please see enclosed.

Question 2 - In an introducing / carrying broker arrangement, the introducing dealer was deemed to be in the best position to follow up directly with the client and has visibility into the client's delivery status through reporting from the carrying broker and/or the client's custodian. Likewise, in an originating / executing dealer arrangement, the originating dealer maintains the relationship with the underlying client and is able to engage with the client in the event of a failure to deliver. We request feedback on this proposed approach and will consider all comments when finalizing the Proposed Amendments.

Rather than CIRO intervention, where a trade is cleared or settled through a carrying intermediary, responsibility may be allocated by written agreement between the parties that identifies responsibility for detection, notification, investigation, decision-making, and record retention.

Question 3 - Do you agree with the proposed timeline of five business days past settlement date as the period within which investment dealers must commence action to address a client failure to deliver where the failure relates to a short sale? Why or why not?

Disagree. Please see enclosed.

Question 4 - Should the timeline for extended failed trade reporting be shortened to align with the proposed timeline of five business days following settlement date for short sales under the Proposed Amendments? Currently the extended failed trade reporting timeline is ten trading days past settlement date under UMIR 7.10.

Please see enclosed.

Question 5 - Have we identified all the proposed provisions that will materially impact clients, investment dealers, 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. Please see enclosed.

Question 6 - Overall, do you agree with CIRO's qualitative assessment of the benefits and impacts of the Proposed Amendments? Please provide reasons for your stance.

Disagree. Please see enclosed.

Question 7 - We are proposing an implementation period of no less than three months after the publication of the final amendments, and request feedback on what implementation period would be appropriate to provide applicable investment dealers with sufficient time to make the changes necessary to comply with the Proposed Amendments

The Revised Proposal should not proceed to implementation. Please see enclosed.