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April 19, 2024

VIA ELECTRONIC DELIVERY

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RE: CIRO RULES BULLETIN 24-0003 – PROPOSED AMENDMENTS AND GUIDANCE
RESPECTING THE REASONABLE EXPECTATION TO SETTLE A SHORT SALE

Dear CIRO:

Virtu Canada Corp. appreciates the opportunity to provide our perspective on the Proposed Amendments and their potential impact on Canadian equity market structure. Virtu Canada Corp. is the Canadian investment dealer arm of Virtu Financial (“Virtu”), a leading global provider of financial services and products that leverages cutting-edge technology to deliver liquidity to the global markets and innovative, transparent trading solutions to its clients.

Virtu and its subsidiaries operate as a market maker across numerous exchanges in the U.S. and is a member of all U.S. registered stock exchanges. Virtu’s market structure expertise, broad diversification, and execution technology enable it to provide competitive bids and offers in over 25,000 securities, at over 235 venues, in thirty-six countries worldwide.

We applaud CIRO on the intent to provide further clarity to market participants on expectations regarding short sales. In addition, we support efforts to ensure the timely delivery of securities by settlement date in connection with short sales, as failed trades may present market risk to dealers as well as additional capital requirements. We also support maintaining the existing rules on the use of short-marking exempt orders by entities with marketplace trading obligations and other activity that qualifies for use of the market.

As noted by CIRO, the reasonable expectation requirement to settle a short sale is not a new requirement, however, in certain cases the proposed guidance raises additional questions instead of answers and we believe CIRO should engage in additional consultation with dealer members to fully understand existing practices in order to build out a more comprehensive guidance notice. Below we have included some specific comments.

Guidance on reasonable methods

The guidance notice provided effectively lays out only two ways to comply with the requirement including maintaining an Easy-to-Borrow (ETB) list or indicating the borrow source on an order-by-order basis. We are concerned with this approach as it is a marked departure from the existing requirement and would effectively result in the introduction of a “locate” requirement in Canada. We do not believe order-by-order locate requirements have been demonstrated to be necessary in Canada at this time. As noted in CSA/CIRO Staff notice 23-332¹, an overly restrictive regime could inhibit legitimate short selling, with negative implications for liquidity and price discovery.

¹ https://www.osc.ca/sites/default/files/2023-11/csa_20231116_short-selling.pdf

In discussions with CIRO staff over the past few months, we have come to understand the intent of the rule is not to introduce a new locate requirement but instead clarify existing requirements. Therefore, we suggest CIRO work to add additional alternate methods in the guidance. We have included some relevant considerations below.

Reliance on other Dealers

The amendments as written, specifically UMIR 3.3 and 3.4, appear to place sole reliance on the executing participant to ensure a reasonable expectation. Notably, the amendments and guidance do not appear to allow any reliance on an originating participant in the case of a jitney order or allow any reliance on a non-executing dealer member. Jitney orders and orders from non-executing dealer members form a notable portion of the Canadian market structure and we submit that these arrangements should be considered explicitly in the amendments and guidance.

Regulation SHO in the United States currently allows dealers to rely on each other for locate purposes. We encourage CIRO to introduce a similar reliance provision such that the originating dealer, whether a participant or not, is responsible for ensuring compliance with the reasonable expectation requirement. The originating dealer will be in a much better position than the executing dealer to determine the source of the order and whether their client has the ability and expectation to make settlement. We further encourage CIRO to allow reliance on foreign dealers subject to an appropriate short-selling regime, such as FINRA dealers subject to Regulation SHO.

Monitoring Requirements

The amendments also introduce a new regular review requirement as part of UMIR Policy 7.1 but notably the guidance accompanying the amendments does not appear to touch on what practices are expected for this review requirement.

We note that effective monitoring may be particularly challenging in an institutional DAP/RAP account context where a participant may not provide custody of the client's securities and thus will not have visibility into a client's current holdings or ability to borrow securities with their custodian. We encourage CIRO to provide examples of monitoring expectations in this type of relationship (while still allowing for alternate practices that meet the objective of identifying instances where client orders may not have reasonable expectation of settlement). We further encourage CIRO to exempt orders originating from another dealer (as discussed above) from this monitoring requirement.

Extension of Restrictions

UMIR 3.4 sets out the existing over-arching requirement from UMIR 6.1 on agency trading such that a participant would be required to ensure pre-borrowing of securities if an extended failed trade report were required in relation to a client's intentional or negligent act. We note that the amendments, in addition to the current rule, do not adequately consider instances where a client may be a large institutional client with many traders or desks operating independently. Notably the rule does not appear to allow for any length of time to pass, or mitigating processes to be implemented by the client, which would allow the participant not to arrange pre-borrowing.

We encourage CIRO to consider this requirement in the context of institutional trading and allow participants greater flexibility to permit short sales without pre-borrowing in cases where a client can demonstrate revised procedures to ensure reasonable expectation of settlement on short sales.

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In closing, while we support providing additional clarity in this area to market participants, we encourage CIRO to conduct additional consultation of current practices and seek to incorporate these into the guidance notice. We are concerned that ambiguity in the amendments and guidance could work contrary to CIRO's stated goal and introduce further confusion instead of providing further clarity.

Virtu appreciates the opportunity to provide our perspective on these proposals and would welcome the opportunity to discuss further with CIRO staff.

Respectfully submitted,

Brandon Boyd
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Virtu Canada Corp.