VIA E-MAIL March 8, 2023

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission of New Brunswick
Superintendent of Securities, Prince Edward Island
Nova Scotia Securities Commission
Superintendent of Securities, Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
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Re: Joint CSA and IIROC Staff Notice 23-329 *Short Selling in Canada*

Background

The Portfolio Management Association of Canada (**PMAC**) is pleased to have the opportunity to respond to Joint CSA and IIROC Staff Notice 23-329 *Short Selling in Canada* (the **Staff Notice**).

PMAC represents over 300 investment management firms registered to do business with the various members of the CSA as portfolio managers (**PM**s). Approximately 65% of our members are also registered as investment fund managers (**IFM**s). PMAC's membership is comprised of firms of varying sizes and models, ranging from one-person firms to international and bank-owned firms. In total, our members manage assets in excess of $3 trillion of assets for institutional and private client

portfolios. Our members also range from the more traditional models to online advisers.

PMAC's mission statement is "advancing standards". We are consistently supportive of measures that elevate standards in the industry, enhance transparency, improve investor protection and benefit our capital markets as a whole. We are also cognizant of the global market in which many of our mid-size and large members operate and are sensitive to any regulatory changes being misaligned with other international capital market jurisdictions.

KEY RECOMMENDATIONS

1. Do not make any immediate changes to the regulatory framework with respect to the Canadian short selling regime; and,
2. Continue to conduct research and to consult with stakeholders regarding the frequency and root causes of failed trades and their relationship to short selling in Canada.

DISCUSSION

As we noted in our response (**2021 Response**) to CSA Consultation Paper 25-403 *Activist Short Selling* in March 2021 (**2021 Consultation**), PMAC generally favours principles-based regulation that recognizes differences in business models, sizes, and client types.

We support the CSA and IIROC's (together, **Regulators**) decision to consult with stakeholders on the important issues raised in the Staff Notice. It is crucial for regulatory bodies to hear from market participants in deciding whether regulatory intervention is required and if so, what form it should take, given the fast pace of change in the industry. We urge the Regulators to base any changes to existing regulation on data and evidence, as opposed to perception. The Regulators should only intervene where there is both a legitimate concern, and a reasonable prospect that the planned intervention will have the desired effect. Any potential direct and indirect consequences of regulation on legitimate capital market activities should be taken into account. Regulation should be proportional and should be designed to reduce regulatory burden to the extent possible (by allowing electronic reporting, for example). Currently, we do not believe there is sufficient evidence to support changes to short selling regulation in Canada.

In PMAC's 2021 Response, we provided a detailed discussion of the role and benefits to the capital markets of legitimate short selling activity, including activist short selling. As noted in the Staff Notice, "Short selling is a legitimate trading practice that helps market participants manage risk, contributes to market liquidity and promotes price discovery," among other benefits. We believe that it is important to dispel negative perceptions of short selling, or perceptions that short sellers necessarily damage the operations of companies. Fundamentally, short selling can impact only

the pricing (and liquidity) of an issuer's securities and has no effect on the business operations of an issuer.

An investor may have a variety of reasons for taking a short position: for example, the investor may believe the stock to be overvalued overall or overvalued compared to its peers, the trade could be part of a paired trade, or the investor may believe the relevant sector may be struggling. The short seller may have previously taken a long position in the same securities, and vice versa. A short position does not necessarily mean that the investor thinks that the company is on the brink of bankruptcy or is poorly run. Providing additional information and education about the uses, benefits and regulation of short selling may be advisable.

PMAC's 2021 Response also drew attention to the potential risks and unintended consequences of additional regulation of short selling activity. We refer you to our 2021 Response.[1] Our members strongly believe that additional requirements on short-selling, and particularly reporting, would have a negative impact on the capital markets, including reduced execution speed and/or quality, reduced access to corporate and secondary issues, and a potential chilling effect on short selling. Short selling is an essential trading activity and represents an important source of liquidity.

Our members that trade both in Canada and the U.S. inform us that they have not experienced more failed trades in Canada as a result of not having a hard locate requirement (which is required in the U.S. under Regulation SHO) and advise that they are very rarely asked to cover a short position. They are not experiencing many problems under the current regime and believe that negative perceptions on short selling are more likely the result of social media statements and surrounding publicity. However, given Canada's overall small market size, there is not as much or as intense focus on most Canadian issuers for the dissemination of misleading information or short and distort campaigns as there have been on U.S. stocks, for example.

Based on the information contained in the Staff Notice, we believe that further research is required to determine whether there is a relationship between short selling and failed trades, including the causes and implications of these failed trades, and that no immediate changes to the short selling regime are warranted. PMAC was interested to learn the results of the IIROC study of failed trades (**2022 Study**). Although the 2022 Study provides useful data and some preliminary information, we believe that it is insufficient to inform regulatory change at this time.

[1] Please also see our response to the British Columbia Securities Commission's Notice and Request for Comment – Proposed British Columbia Instrument 51-519 *Promotional Activity Disclosure Requirements*

We provide some brief responses to the questions in the Staff Notice below:

1. **Should the existing regulatory regime around pre-borrowing in certain circumstances be strengthened? What requirements would be appropriate? Specifically, should there be "pre-borrow" requirements similar to those in the U.S., as described above? Please provide supporting rationale and data.**

The Staff Notice notes that there is an existing regime that regulates short selling activity in Canada, and that the Canadian regulatory regime is consistent with IOSCO principles; the existing regime seems to be working as intended and effectively prohibits naked short selling. It does not appear that naked short selling is a significant concern in Canada. If a response to naked short selling is determined to be necessary, we suggest an examination of additional information or research to determine the costs and benefits of such a change, and whether changes will achieve the desired outcome of preventing undesirable short selling activity.

As noted in our 2021 Response, there does not appear to be sufficient evidence of widespread failed trades, or data to support pre-borrow requirements similar to those in the U.S. The 2022 Study provides limited information with respect to the relationship between short selling and failed trades. It indicates that some types of securities and some exchanges may be more susceptible to failed trades. Additional research should be conducted to continue to monitor for any increase in failed trades, and to better understand the reasons behind the failed trades.

The IIROC Staff Notice 22-0130 *Guidance on Participant Obligations to Have Reasonable Expectation to Settle any Trade Resulting from the Entry of a Short Sale Order* published in August 2022 elaborated on the "reasonable expectation" standard for settlement on the settlement date, including "that prior to the entry of a short sale order a Participant has reasonable certainty that it can access sufficient securities for it to settle any resulting trade on settlement date." The reasons for and impact of this change to the guidance is not explained in the Staff Notice. However, under the existing UMIR regime, it would be difficult for a short seller to engage in repeated "naked" shorts, since continuing to trade after repeated failed trades would force the dealer to cease accepting the short trades.

The Regulators should research what impact or improvement pre-borrowing requirements have had on short-trade settlement issues or failed trades in the U.S. in order to balance the costs of implementation against any benefits of such requirements. Under the existing IIROC regime (which does not include a locate requirement), there are not many failed trades in Canada, either on absolute basis or in comparison to the U.S. (which does have a hard locate requirement). Some members note that this has been their experience, even taking into account less liquid Canadian securities such as small cap securities; they advise that they are very rarely asked to cover a short position. Our members are concerned that pre-

borrowing requirements could slow execution, and result in higher turnover in short selling activity in general; this would have chilling effect on legitimate and essential short selling activity.

2. **What would be the costs and benefits of implementing such requirements?**

As we noted in our 2021 Response, instituting a pre-borrow or "hard" locate requirement similar to the requirement in the U.S. would be an additional regulatory burden on all short selling activity, rather than targeting attempts to engage in naked short sales. Instead, focusing on buy-ins may be a better approach, because this would tailor the regulatory response to the perceived problem and the responsible parties, rather than on all legitimate short selling activity. The costs required for industry participants to upgrade trading systems (to obtain locates electronically, for example), would be significant.

3. **Does the current definition of a "failed trade", as described in Part 1, above, appropriately describe a failed trade?**

We believe that the definition of a "failed trade" as described in Part 1 is appropriate.

4. **Should a timeline shorter than ten days following the expected settlement date be considered? What would be an appropriate timeline? Please provide rationale and supporting data.**

We are of the view that any change to the timeline for filing an Extended Failed Trade Report (**EFTR**) should be based on empirical evidence and data. This would include the reasons for failed trades and the average time to settle a failed trade after the expected settlement date. We do not believe that the existing data currently supports making a change. The shortening of the settlement cycle to T+1 may be a factor to consider with respect to shortening the timeline (the shortened settlement cycle may itself reduce the incidence of failed trades). We urge the Regulators to closely monitor for impacts of the shortened cycle on trades of concern. A shorter EFTR timeline is likely to result in an additional compliance burden and costs for market participants, and therefore the costs and benefits of such a change should be carefully considered.

5. **Should additional public transparency requirements of short selling activities or short positions be considered? Please indicate what such requirements should be and the frequency of any disclosure. Please also provide a rationale and empirical data to support your suggestions or to support why changes are not needed.**

PMAC would like to better understand what regulatory goals transparency requirements, such as disclosing the identity of short sellers, position size reporting and other disclosure, are expected to achieve. These tools should be carefully studied to determine whether they have had the effect of diminishing abusive practices in

other jurisdictions, as well as whether they have had an undesirable negative impact with respect to information available to the markets, price discovery and some of the other advantages to legitimate short selling.

As we noted in our 2021 Response, requiring additional position disclosure and transparency may inadvertently encourage other undesirable behaviour and lead to a less efficient market. Studies cited in the 2021 Consultation observed undesirable effects of disclosure such as compromising strategies used by short sellers, leading to decreased market liquidity or price discovery. PMAC members agree that disclosure of short positions, which is sensitive information, can have unintended consequences such as revealing an investor's strategy, potentially enabling others to generate a short squeeze, and otherwise discouraging short selling within the market (for example because revealing a short position would damage the relationship between the investor and the target).

The 2021 Consultation noted that disclosure is viewed as a deterrent to short selling generally in other jurisdictions. We do not believe that deterring short selling in Canada is a desirable outcome (whether intended or unintended), and question whether this will, in fact, improve the efficiency of our capital markets. The Regulators should research the costs and benefits of requiring public disclosure of positions in other jurisdictions. PMAC members are concerned that there will be reduced access to less common securities such as corporate issues or secondary deals if public disclosure is required, as issuers may be sensitive about being shorted.

6. **Should additional reporting requirements regarding short selling activities be considered by the securities regulatory authorities? Please indicate what such requirements should be and the frequency of any disclosure. Please also provide a rationale and empirical data to support your suggestions or to support why changes are not needed.**

The Staff Notice includes a review of some of the regulatory tools and initiatives in use or under consideration in other jurisdictions, such as the U.S., Australia, and the EU, to regulate short selling. The use of reporting thresholds is one such tool. However, as noted in the 2021 Consultation, at least one study indicated that imposing short position reporting thresholds, or reducing those thresholds, simply results in short sellers cutting back their short selling activity to remain below the reporting threshold, such that the threshold may be counterproductive. As PMAC noted in our 2021 Response, one of our members that is required to report in Australia reported that, although they provide the necessary information to Australian authorities when engaging in short selling (which requires a fair amount of effort), they have never been contacted by the regulator and have no insight into whether or how the authorities use the information, beyond public disclosure of positions on an aggregated basis.

Reporting as a regulatory tool is typically used either to determine the efficacy of a rule or potential rule (i.e., to determine whether regulation is necessary or if existing regulation related to a specific issue is working), or to review systemic risk (i.e., all the data put together reveals that something is wrong or is about to go wrong). It would be helpful for the Regulators to examine how the information is being used in other jurisdictions and whether it is useful in diminishing undesirable outcomes. If the reporting is made only to regulators (as opposed to being public), it would not impact the "short and distort" problem. Some issuers have called for symmetry between long and short position reporting. However, the regulatory basis for the current regulations directed at reporting long investment positions (such as insider reporting and early warning reporting in Canada) is typically motivated by concerns directed at publicly identifying parties able to significantly influence the control of an issuer, which are not relevant concerns in respect of short selling.

The Regulators should also consider whether tools adopted in other jurisdictions were aimed at problems that were specific to the jurisdiction and responsive to market events that may not be applicable in the current Canadian landscape. We urge the Regulators to assess whether the tools used to regulate short selling activities in other jurisdictions achieved their intended outcomes, and specifically whether they resulted in fewer "short and distort" campaigns.

The Staff Notice also notes that other jurisdictions such as the U.S. and EU are currently undertaking reviews and consultations with respect to their reporting regimes. The Regulators should determine whether the changes being contemplated in other jurisdictions are ultimately implemented, and whether they improve market outcomes. The Regulators should also consider any negative or unintended consequences caused by the regulatory responses in these jurisdictions.

7. **As noted above, IIROC's study of failed trades showed that correlations between short sales and settlement issues in junior securities were more significant, and that junior securities experience more settlement issues compared to other securities. Should specific reporting, transparency or other requirements be considered for junior issuers? Please provide additional relevant details to support your response.**

We do not believe that the 2022 Study provides sufficient information with respect to the reasons why junior securities experience more settlement issues to justify a regulatory response. The causes of these issues should be better understood in order to determine whether additional reporting, transparency or other regulatory requirements would appropriately address the problem. The costs, benefits and potential unintended consequences of imposing such requirements on a specific class of issuers should also be carefully considered. We believe that, based on the existing information, any regulatory response would be premature.

8. Would mandatory close-out or buy-in requirements similar to those in the U.S. and the European Union be beneficial for the Canadian capital markets? Please provide rationale and data substantiating the costs and benefits of such requirements on market participants.

As we noted in our 2021 Response, we are uncertain as to whether there is sufficient evidence of widespread failed trades to warrant this change, and whether data exists to support this measure. We believe that if the Regulators determine that regulatory change is necessary, focusing on buy-ins (as opposed to pre-borrowing or a locate requirement) would appropriately tailor the regulatory response to the perceived problem, and on the responsible parties.

Conclusion

There does not appear to be sufficient data, evidence or rationale to support changes to the current regulatory framework with respect to the short selling regime. The Regulators should therefore not make any immediate changes. Any decisions regarding new regulation in this area should be based on data and evidence rather than perception. The measures suggested in the Staff Notice seem to be primarily directed at preventing failed trades. The existing evidence suggests that failed trades are not a prevalent or pervasive issue in Canada. As we noted in our 2021 Response, the public perception problem with short selling seems to be driven by concerns around misleading statements and short and distort campaigns, which would not be addressed by requirements like pre-borrowing, disclosure, reporting etc.

We are concerned that efforts to regulate short selling may have unintended negative consequences such as decreased liquidity, increased trading costs, loss of information to the market and price uncertainty. Our members are concerned that such pre-borrowing requirements would slow execution, increase turnover in short selling activity in general, and create a chilling effect on legitimate and essential short selling activity. Regulators should consider the costs and benefits of various regulatory options and the experiences of other jurisdictions before deciding which route to take. Regulation should narrowly focus on specific behaviours and desired outcomes. The change to a T+1 settlement period is likely to have a significant impact on settlement; no new regulation should be introduced that could further affect settlement until the impact of the move to T+1 is better understood. We applaud the Regulators' efforts to gather feedback from market participants on the extent and effect of activist short selling in Canada and to consider the experience of other comparable jurisdictions.

We urge the Regulators to continue to conduct research and to consult with stakeholders regarding the frequency and root causes of failed trades and their relationship, if any, to short selling in Canada.

Thank you for the opportunity to respond to the Consultation. If you have any questions regarding the comments set out above, please do not hesitate to contact Katie Walmsley at (416) 504-7018 or Victoria Paris at (416) 504-1118.

Yours truly,

PORTFOLIO MANAGEMENT ASSOCIATION OF CANADA

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