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RE: CIRO Consultation 24-0003 - *Proposed Amendments Respecting the Reasonable Expectation to Settle a Short Sale*

CNSX Markets Inc., operator of the Canadian Securities Exchange (CSE), thanks the Canadian Investment Regulatory Organization of Canada (CIRO) for the opportunity to provide feedback on CIRO Consultation Notice 24-0003 – *Proposed Amendments Respecting the*

Reasonable Expectation to Settle a Short Sale (24-0003 or Consultation) and the *Proposed Guidance on UMIR Requirements Related to Short Selling and Failed Trades* (Guidance). Unless otherwise indicated, we have used the same defined terms as used in the Consultation and the Guidance.

We would first like to commend the staff involved in the preparation of the Consultation and the Guidance for their careful analysis of the current Canadian short selling framework under UMIR and we appreciate the thoughtfulness that has gone into the proposed amendments. We would also like to express our appreciation for the work that is going in to ensuring that the regulatory regime in Canada is responsive to industry and stakeholder concerns and feedback.

As we wrote in our response (2023 Letter) to the Joint Canadian Securities Administrators and Investment Industry Regulatory Organization of Canada Staff Notice 23-329 - *Short Selling in Canada* (Joint Notice) we continue to believe that the rules and regulations currently in place in Canada for short selling are sufficiently robust to address most instances of abusive short selling practices.

Still, since our 2023 Letter, the sentiment that abusive short selling is a feature of the Canadian equity capital markets has not only continued to persist among CSE's issuers and the parts of the trading community focused on the early stage company market but has infiltrated the conversation of the broader trading community and has become a leading topic of nearly all of our stakeholder conversations involving trading and equity markets in Canada.

Close-outs Requirements

We confirm that, in our view, the proposed amendments and the Guidance help further strengthen and provide clarity to an already robust regime. For instance, the introduction of an affirmative obligation for dealers to have a reasonable expectation to settle on the settlement date before entering an order that would result in a short sale will help alleviate some of the stakeholder concerns regarding possible inter-dealer arrangements that may

have resulted in persistent settlement failures in certain securities that we described in our 2023 Letter.

However, in order to fully address the issue of abusive practices and the broader persistent negative sentiments about short selling in Canada, we continue to be of the view that more specific requirements should be introduced with respect to close-outs, a topic that is noted in the Consultation as an area currently being explored by CIRO Staff as one where additional regulatory measures may be appropriate. We have considered options for introducing mandatory close-out requirements through amendments to CSE Trading Rules, but we ultimately determined that only an initiative with broader regulatory scope would be effective. We would be happy to meet to discuss our considerations.

In our 2023 Letter, we suggested that the structure provided in US Reg SHO for a prescribed buy-in rule would help address many of the concerns about inter-dealer short selling arrangements in Canada. While there are a number of factors that would still need to be considered to ensure that any timeframes that would underpin a mandatory close-out requirement be appropriately designed for the Canadian markets, such as the category of Issuer (junior/senior) or type of instrument (equity/ETF/other), we believe that there should ultimately only be one prescribed buy-in timeframe for all securities so as not to increase complexity for the market.

Impact on Cashless Options and Warrants

In addition to the above, we would also like to draw your attention to the concerns shared with us by some of Canada's independent dealers. They are concerned about the complexities that such a requirement could introduce to their operations as they relate to the administrative aspects of cashless exercises of options and warrants. Warrants and options are a significant part of the financing terms in the venture markets and the ability to exercise these in the T+2/T+1 environment is critical to smaller companies.

In a cashless exercise, a common practice for retail investors, the warrant holder or option holder instructs their dealer to exercise the warrant or option (thereby acquiring a long position in the security) and then simultaneously provides instruction to sell the shares that would be acquired as part of the exercise of the warrant or option. The holder then receives the amount that would be netted after the purchase and sale rather than having to first fund the exercise (purchase) in full and await the delivery of the underlying shares in order to then sell thereby exposing themselves to the risk of possible unfavorable market moves.. As the issuance of the underlying shares is administered by the issuer's transfer agent, the ultimate delivery of these underlying shares relies on the efficiency of the transfer agent rather than the dealer involved in facilitating the transaction. Therefore, in a mandatory close-out regime, if the transfer agent involved is not able to process the issuance of the underlying shares in a sufficiently timely manner, the cashless exercise practice described above could potentially result in a failed trade.

If these trades, the possible failure of which is a result of delays outside of the seller's and the dealer's control, are captured by a mandatary close-out requirement, there is a risk that dealers may choose to deny cashless exercises for certain issuers or certain transfer agents. That has the potential to negatively impact investors who are frequently the holders of such instruments as well as the junior issuers who may rely on using these instruments to attract capital investments in their growing companies.

If CIRO ultimately determines that a mandatory close-out requirement is appropriate to address any persistent concerns about failed trades and short-selling practices in Canada, we urge that it consider the treatment of the exercise of cashless options and warrants. A possible solution would be the inclusion of bona-fide exemptions to the requirements accompanied with dealer supervisory requirements.

We will gladly work with CIRO Staff and the industry at large to determine the appropriate parameters for any close-out requirements. We would also be pleased to further discuss the issues that we have raised and provide thoughts and suggestions around additional

regulatory action that could be beneficial to countering the prevailing narrative of the persistence of abusive short selling in Canada's capital markets.

Sincerely,

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