

Regulators hit pause on substantial reforms to the short selling regime

November 27, 2023

Canadian securities regulators continue to grapple with the appropriate regulation of short selling and establishing a regime which provides investor protection, while promoting legitimate shorting.

What you need to know

- On November 16, 2023, the Canadian Securities Administrators (the CSA) and the Canadian Investment Regulatory Organization (CIRO) published [CSA/CIRO Staff Notice 23-332 Summary of Comments and Responses to CSA/IIROC Staff Notice 23-329 Short Selling in Canada](#) (Staff Notice 23-329).
- In their summary, the CSA and CIRO noted there was no clear consensus from commenters on the appropriate regulatory regime for short selling.
- CIRO is actively reviewing the existing requirement to have a reasonable expectation to settle on the settlement date in an effort to strengthen and clarify the rule.
- The regulators plan to form a staff working group in early 2024 to broadly examine short selling issues in the Canadian market, beginning with an analysis of mandatory buy-in and close-out requirements.
- As [reported in our earlier article](#), Staff Notice 23-329 provided an overview of the existing short selling regulatory landscape, while seeking further input from market participants on areas of regulatory consideration.

Further guidance expected

Although no substantial regulatory reforms are being proposed as a result of the Staff Notice 23-329 consultation, CIRO is actively considering ways to clarify and support the existing requirement to have a reasonable expectation that sufficient securities will be available to settle a short sale trade on the settlement date. The regulators confirmed that [CIRO Notice 22-0130 Guidance on Participant Obligations to have Reasonable Expectation to Settle any Trade Resulting from the Entry of a Short Sale Order \(August](#)

[17, 2022](#)) does not provide a new interpretation of this requirement. Subject to CIRO Board approval, relevant proposals will be published for comment in early 2024.

Further, the CSA and CIRO are expected to form a staff working group in early 2024 to broadly examine short selling issues in the Canadian market. This will begin with an analysis of potential mandatory close-out or buy-in requirements, which have been adopted in a number of other jurisdictions. For example, beginning in November 2025, the European Union will require a buy-in to be initiated within a prescribed time period. A buy-in is initiated by a buyer who has not received the securities purchased on the date of settlement. In this case, the buyer purchases securities to cover the delivery failure, while the seller is responsible for any increase in price between the failed trade and the buy-in trade(s).

Mandatory close-out rules are currently in place in the United States and apply to a dealer that has failed to deliver the securities on the date for settlement, regardless of whether it is in connection with a long sale or short sale. In this case, the dealer must close out the failed position by borrowing securities or purchasing them in the open market.

All proposed changes from the working group's recommendations will consider the impact of the move to T+1 settlement cycle, and will be published for public comment in the normal course.

Areas for further study

While there was generally no consensus among the comment letters received in response to Staff Notice 23-329, the CSA and CIRO noted the following areas as possible matters for further consideration:

- **Pre-Borrow Requirements** : Commenters were split on the implementation of a pre-borrow or locate requirement similar to the United States. Pre-borrowing requires arrangements to be made prior to entering a short sale order and locating imposes a duty on the dealer to have reasonable belief that the shares are readily available for borrowing in time to deliver on the settlement date.
- **Different Treatment of Junior Issuers** : There was minimal support for a regime that differentiates between junior and senior issuers.
- **Shortening Timeline for Reporting Failed Trades** : There was no consensus among commenters to shorten this timeline.
- **Transparency** : There was no consensus among commenters as to whether the market benefits of increasing transparency outweigh its negative implications for liquidity and price discovery.
- **Mandatory Close-Outs/ Buy-Ins of Short Position** : Several commenters supported the introduction of mandatory buy-ins or close-outs.

While the CSA and CIRO continue to consider potential improvements to the short selling regime to address activities that increase risk to investors, there remains an acknowledgement that short selling is a legitimate and vital function that contributes to the liquidity and efficient operation of Canadian capital markets.

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