March 3, 2021

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Financial and Consumer Affairs Authority of Saskatchewan
The Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission (New Brunswick)
Superintendent of Securities, Prince Edward Island
Nova Scotia Securities Commission
Superintendent of Securities, Newfoundland and Labrador
Superintendent of Securities, Yukon Territory
Superintendent of Securities, Northwest Territories
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The Secretary, Ontario Securities Commission
20 Queen Street West 22nd Floor
Toronto, Ontario M5H 3S8

Dear Sirs/Mesdames:

RE: CSA Consultation Paper 25-403 – Activist Short Selling

About Alternative Investment Management Association (AIMA)

AIMA was established in 1990 as a direct result of the growing importance of alternative investments in global investment management. AIMA is a not-for-profit international educational and research body that represents practitioners in alternative investment funds, futures funds and currency fund management – whether managing money or providing a service such as prime brokerage, administration, legal or accounting.

AIMA's global membership comprises approximately 2,000 corporate members in more than 60 countries, including many leading investment managers, professional advisers and institutional investors and representing over $2 trillion in assets under management. AIMA Canada, established in 2003, has approximately 140 corporate members.

The objectives of AIMA are to provide an interactive and professional forum for our membership and act as a catalyst for the industry's future development; to provide leadership to the industry and be its pre-eminent voice; and to develop sound practices, enhance industry transparency and education, and to liaise with the wider financial community, institutional investors, the media, regulators, governments and other policy makers.

The majority of AIMA Canada members are managers of alternative investment funds and fund of funds. Most are small businesses with fewer than 20 employees and $50 million or less in assets under management. The majority of assets under management are from high net worth investors and are typically invested in pooled funds managed by the member.

Investments in these pooled funds are sold under exemptions from the prospectus requirements, mainly the accredited investor and minimum amount investment exemptions. Manager members also have multiple registrations with the Canadian securities regulatory authorities: as Portfolio Managers, Investment Fund Managers, Commodity Trading Advisers and in many cases as Exempt Market Dealers. AIMA Canada's membership also includes accountancy and law firms with practices focused on the alternative investments sector.

For more information about AIMA Canada and AIMA, please visit our web sites at canada.aima.org and www.aima.org.

Comments

We are writing in response to **Canadian Securities Administrators (CSA) Consultation Paper 25-403 – Activist Short Selling**

Overall, AIMA Canada supports the objective of reviewing short selling regulation and commends the (CSA) on this initiative. We were pleased to see that the consultation noted proactively the many benefits of short selling as a "legitimate trading practice" and how "it also contributes to the price discovery process by providing an opportunity for negative views about the issuer to be reflected in the price of a security thereby limiting overvaluation and biased price increases." We are pleased to see the paper note "short selling can also be an important part of an investor's hedging and investment risk management strategy." AIMA too has published research on the benefits of short selling and even the benefits of short selling and responsible investment.

AIMA believes that activist short sellers play an important role in financial markets and welcomes the CSA's acknowledgement that they "can serve as a countervailing check on the potential for excessive market optimism".

Dedicated short sellers in effect perform the role of forensic detectives, discovering clues that are usually hidden in plain sight and overlooked by most of the market. They can highlight companies' exaggerations of financial outlook, accounting irregularities or outright fraud. They publish the result of their analysis to alert the general market, which might in turn lead to a fall of the share price of the analyzed companies. Sometimes by a little if the problems highlighted do not amount to much, sometimes by a lot if the problems are serious. Short sellers benefit from such price falls as they usually take their positions prior to the publication of their analysis.

Companies that are subject to such activist short selling campaigns have in many cases reacted with anger and blamed short sellers for spreading incorrect or false information. This criticism is not, in our view, generally valid. Short sellers have to be extremely careful not to mislead the public with a view to benefiting from that. That behavior is illegal in all financial markets and a criminal offence in most developed markets.

Activist short selling is thus one of the most difficult investment techniques to carry out and be profitable. Not only will short sellers need to spot things that the entire financial market composed of skilled analysts has failed to spot, they will also need to be extremely careful in their analysis and make

sure that they do not engage in negligent or reckless behavior as this could and has sometimes resulted in serious penalties.

Hence, short sellers play an extremely important role in public markets, not only by providing liquidity and better price formation through their contrarian positioning, but also by performing a policing function that keeps corporations and their management honest. Often the short seller is described as the 'canary in the coal mine', providing valuable information to the world about the toxicity of the environment that is hard to spot.

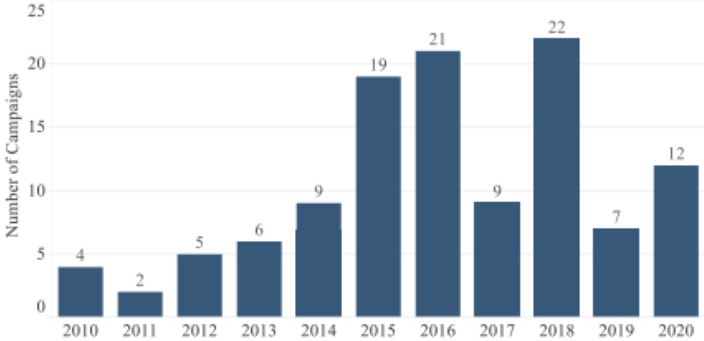
Short sellers therefore benefit ordinary investors in two ways. First, by alerting them to troubles in the companies they invest in which enables them to either put pressure on company management to rectify the situation or to divest before the shares fall even further. Second, by dissuading wrongdoing in the first place. Knowing there are financially motivated investors out there who scrutinize all the information companies provide to the market means that management is likely to be more prudent and refrain from engaging in aggressive accounting techniques, trying to paint an excessively rosy picture of the future, or engage in fraud.

Short sellers can therefore be seen as one of the fundamental pillars of capital markets' sustainability and their long-term success. Capital markets operate on the basic assumption that information provided to investors is correct and not misleading. Without that, markets will lose investor confidence and honest entrepreneurs will not be able to raise money from the public. Regulators and the state can certainly play a role of policing the markets but they will never have the resources and the financial motivation to engage in the type of detective work short sellers have.

Public policy and the broader investor community must understand these tangible benefits of an activity that has the potential to generate public controversy. Yes, short sellers sometimes make money when other investors lose but that is only the proximate effect of their activity. Their long-term effect is a maintenance of the very essence of capital markets – ensuring that there is as much information circulating in the market which is then accurately reflected in the prices of securities. Short selling is therefore long-termist.

With respect to the Canadian market specifically, the Consultation Paper also rightly highlights the fact that the scale of activist short selling campaigns in Canada is not disproportionately high relative to the U.S. market and that the absolute number of campaigns remains modest (cf. Consultation Paper Figure 1), with 2019 seeing the lowest number of campaigns since 2013.

Figure 1 - Activist Short Seller Campaign Activity in Canada (2010 – Sept. 2020)



It is very difficult to infer from the data that there is a) an increasing trend of short selling campaigns

in Canada and that b) whatever the trend is, the number of short selling campaigns is excessively higher in Canada than the United states. Indeed, one could convincingly argue that there is a common downward trend in short selling campaigns in both Canada and the U.S. – and that is despite the differences in the legal and regulatory framework related to short selling.

It is clear that short selling plays an important role in securities markets and that there should be rational incentives inherent in the marketplace to reward the knowledge, fact discovery and analysis necessary to effectively identify shorting opportunities. This needs to be distinguished from a short seller that intentionally disseminates false or misleading information about an issuer which can cause significant and lasting harm to the target issuer, the issuer's security holders and the capital markets generally. Issuers are prejudiced by this conduct since it may unfairly tarnish their reputation and can have a calamitous effect on their market capitalization and secondary effect on the target's business. Security holders that are induced to sell on the basis of misinformation or who otherwise sell during the time this misinformation affects the price suffer a loss equal to the difference between the "true" value of the issuer's securities and the artificially low price at which they sell multiplied by the number of securities sold. Finally, "short and distort" campaigns have a negative impact on the capital markets as whole, as market participants lose confidence in their fairness and integrity if unscrupulous short sellers deliberately spread false and misleading information and realize a profit at the expense of an issuer and its security holders. We note that such behaviour is also problematic when a security holder with a long position intentionally disseminates false or misleading information intending to inflate the trading prices of an issuer's securities.

As indicated above, AIMA is supportive of the efforts the CSA has made and continues to make to thoroughly investigate and understand the impact that short selling, and more particularly activist short selling, has on the Canadian market. We recognize that the CSA is charged with the difficult task of ensuring the regulatory regime in place finds the appropriate balance between preventing or deterring deleterious behaviour while facilitating the important role that short selling plays in an efficient market. AIMA echoes the CSA's position that there is insufficient evidence to support significant changes to the current regulatory regime in Canada as it relates to short selling and we would welcome a more measured approach of addressing abusive short-selling activities through enforcement of existing rules. As noted in the Consultation Paper, securities law in most Canadian provinces prohibits a person or company from: (a) directly or indirectly engaging or participating in any act, practice or course of conduct relating to securities that the person knows or reasonably ought to know results in or contributes to a misleading appearance of trading activity in, or an artificial price for, a security; (b) perpetrating a fraud on any person or company; and (c) making a statement that the person or company knows or reasonably ought to know, in a material respect and at the time and in light of the circumstances under which it is made, is misleading or untrue or does not state a fact that is required to be stated or that is necessary to make the statement not misleading and would reasonably be expected to have a significant effect on the market price or value of a security.[1] In addition, securities regulators have broad powers to sanction conduct that is prejudicial to the public interest even in circumstances in which there has been no breach of the applicable act, but where a party's conduct is abusive of investors or the capital markets or is inconsistent with the animating

[1] Ontario Act, *supra* note 2, ss 126.1 and 126.2; *Securities Act* (Québec), CQLR c V-1.1, ss 196, 197 and 199.1; *Securities Act* (Alberta), RSA 2000, c S-4, ss 93 and 221.1; *Securities Act* (British Columbia), RSBC 1996, c 418 (the "**BC Act**"), ss 57 and 168.1; *Securities Act* (Manitoba), CCSM, c S50, ss 112.3 and 136; *The Securities Act, 1988* (Saskatchewan), SS 1988-98, c S-42.2, ss 55.1 and 55.11.

principles underlying a particular requirement.[2] Accordingly, an activist's attempt to depress an issuer's stock price by knowingly spreading material misinformation is already prohibited conduct capable of redress by the CSA.

The debate regarding activist short selling in Canada has too frequently been based upon anecdotal evidence and conjecture rather than an analysis of available empirical data. The methodical approach in the Consultation Paper supports the conclusion that activist short selling campaigns are not particularly prevalent in Canada.[3] As the Consultation Paper notes, there were more than a dozen activist campaigns in a single year just three times since 2010 (Figure 1). Moreover, the data in the Consultation Paper states that the proportion of Canadian issuers targeted by activist campaigns is significantly lower than the proportion of U.S. issuers targeted by activist campaigns. To some extent, this is a reflection of the differences between the Canadian and U.S. markets generally; the average U.S. public company is larger and its securities are more liquid than the average Canadian public company, which would make the U.S. company more attractive to an activist short seller assuming that all else was equal.

Further, it is unclear from the data what percentage of the campaigns cited in the Consultation Paper may be considered as "short and distort" campaigns and which identified actual problems with the issuer. The Consultation Paper notes that 73% of targets pursued certain responses during a campaign which included changing or replacing the CEO or CFO and hiring a new auditor or independent investigator, responses which may suggest that an actual problem was identified by the campaign.

If the unique nature of the Canadian market serves as a natural deterrent against activist short selling campaigns and lack of empirical evidence regarding the nature of such campaigns, the importance of not over-regulating the practice becomes even more pronounced, as such over-regulation could reduce or eliminate the numerous benefits that short selling provides to our capital markets.

Nevertheless, the fact that activist short selling is a relatively infrequent occurrence does not mean that it should be ignored or that abusive activist short selling campaigns should not be addressed. The frequency of abusive campaigns – or the ostensible lack thereof – ought to be relevant to an assessment of whether the Canadian regulatory landscape should be fundamentally altered in a manner that could have far-reaching, negative consequences.

Recently, the Capital Markets Modernization Taskforce (the "Taskforce") published its final report in which it recommended a new prohibition against making misleading or untrue statements about public companies and that would allow the OSC to bring an enforcement action against any person that makes or attempts to make statements that are known to be, or for which there is a reckless disregard for whether the statements are, misleading or untrue, and when those statements would be expected either to affect the market price or value of the securities of an issuer or influence the

[2] *Re Canadian Tire Corp* (1987), 10 OSCB 857 at para 130; *Re Seto*, [2003] ASCD No 270 at paras 40 to 43; *Re Patheon Inc* (2009), 32 OSCB 6445 at para 114; *Re Donald*, 2012 ONSEC 26 at paras 304 to 308; *Re Catalyst Capital Group Inc*, 2016 ONSEC 14 at para 24.

[3] We recognize that the CSA's research was limited to data gathered by Activist Insight, a third party data provider that only tracks campaigns by prominent activist short sellers. We believe that this is appropriate, as it will be rare for a less prominent activist short seller to materially affect the market price of an issuer's securities or impact the investment decisions of an issuer's security holders. In this regard, we agree with the points made by the Alberta Securities Commission in *Re Cohodes*, 2018 ABASC 161 that a short seller's opinions must command a certain level of respect among market participants to be impactful, and that a less prominent activist may only impact the market of a small, thinly-traded issuer in certain circumstances (paras 82 to 83).

investment decision-making of a reasonable investor. We note that no materiality threshold appears to be contemplated and the market impact assessment is one of two alternative prongs that could ground liability. Although the Taskforce's report notes that the new prohibition is not intended to capture analysts that may omit facts without an intention to mislead or reputable activist short sellers, it is not clear how the Taskforce is proposing to thread that particular needle.

In our view, both the amendments to the BC Act and the Taskforce's recommendation are overreactions to a perceived problem based on little more than anecdotal evidence. The elimination of a market impact assessment and a materiality threshold can be expected to have a significant chilling effect on legitimate short selling activities given that these market participants do not have access to company information beyond what the company itself publicly discloses and are therefore forced to form opinions and draw conclusions from their own work and investigation. Any benefits that could be derived from such overly-broad prohibitions do not nearly outweigh the costs.

In addition, if the Taskforce's recommendation is implemented in Ontario, Canada will have three distinct regimes with which market participants will have to comply. This is antithetical to the spirit of harmonization to which the CSA has continually and unreservedly expressed its commitment. As the CSA recently stated, "[i]t is fundamental to keep in mind that a highly harmonized securities regulatory system ensures the best possible outcomes for the Canadian capital markets and adhering to this foundational principle is critical to ensure our regulatory system remains efficient and responsive."[4] In light of the research conducted by the CSA in connection with the Consultation Paper, the BC Act should be amended to revert to the previous iteration of the prohibition on misleading or untrue statements and the OSC and the Ontario Ministry of Finance should not to implement the Taskforce's recommendation. These steps would promote harmonization with other Canadian jurisdictions, thereby decreasing the risk of forum shopping and minimizing fragmentation with respect to investors' rights and obligations throughout the country.

Supportable Incremental Amendments

Although we believe that the overarching securities regulatory regime appropriately regulates activist short selling, certain tailored and incremental modifications may be appropriate in order to assist in addressing instances of abuse, without constraining legitimate short selling activity. As noted above, it is critical that the bar for what constitutes illegitimate conduct not be lowered to make it easier for securities regulators to prosecute short selling per se, as this would have a significant chilling effect on legitimate short selling campaigns specifically and free speech generally.

The U.S. Securities and Exchange Commission (the "SEC") introduced the "uptick rule" in 1938 and it remained in force until 2007. The uptick rule applied to all New York Stock Exchange-listed stocks and required short sales to take place on an uptick (i.e. at a price higher than the last reported transaction price). The purpose of the rule was to prevent successive short sales at progressively lower prices; instead, traders could short securities only on a price uptick (or later, a zero-plus tick). Following its elimination in 2007, the SEC re-introduced a modified version of the uptick rule in 2011 that did not apply unless a circuit breaker had been triggered by a 10% price decline in a particular security in a trading day. Unlike the U.S., Canada no longer has an uptick rule following its repeal in 2012. Although IIROC noted in its 2011 consultations that its studies supported the premise that the uptick rule has no appreciable impact on pricing, IIROC neither sought nor received specific comments on the use of circuit breakers in Canada. We appreciate that views regarding the efficacy of the modified uptick rule are mixed. However, in light of the fact that the rule has been in effect in the U.S. for over a decade,

[4] CSA, "Open Letter from the CSA in Response to the Capital Markets Modernization Taskforce final report" (12 February 2021) online: <https://www.securities-administrators.ca/aboutcsa.aspx?id=2018>.

we believe that there is now additional data that can help to inform IIROC's analysis regarding the potential value of adopting a similar version of the modified uptick rule in Canada.

Short sellers are not, and should not be, obligated to disclose their short positions. In this regard, we agree with the conclusions of the studies cited in the Consultation Paper that such disclosure would have undesirable effects, and that short sellers would likely choose to remain below the applicable disclosure threshold in order to maintain privacy, something that has been evident in the context of European requirements. ESMA's December 2017 'Final Report: Technical Advice on the evaluation of certain elements of the Short Selling Regulation'[5] indicated that public short disclosure rules prompt a change in market participants' behavior, creating the potential for pricing inefficiencies. Public transparency is also associated with increased herd behavior for two reasons. First, investors may assume that those who go public are likely to be better informed and decide to replicate their competitor's strategy. Second, investors may be less concerned with keeping their strategy secret once another investor has gone public and decide to take a larger position.[6]

CONSULTATION QUESTIONS:

11. Is the existing disclosure regime for short selling activities adequate? Please explain why or why not, indicating:
a. what disclosure requirements would address risks associated with potentially problematic activist short selling and how would such requirements improve deterrence;
b. what should be the trigger and the timing of any additional disclosure;
c. how can additional disclosure be meaningful without negatively impacting market liquidity; and
d. do you foresee any issues with imposing a duty to update once there has been a voluntary disclosure of a short position?

We believe that the existing disclosure regime strikes the necessary balance between discouraging abusive short-selling activities and not discouraging short-selling activities that support an efficient market.

12. In your view, do the existing enforcement mechanisms adequately deter problematic activist short selling? If so, why? If not, why not?
a. Can deterrence be improved through specific regulation of activist short sellers? If so, how?

As stated above, the Consultation Paper itself notes that activist short selling campaigns are not particularly prevalent in Canada, and those that can be viewed as abusive are relatively low. Regulating short selling alone, rather than holding all market activity, long and short, to the same standard, does not appear to be warranted. Deterring abusive short-selling activities through regulatory enforcement can be achieved using the regulators' current anti-market manipulation tools. If it is believed that detection and identification of abusive short sellers could be better enhanced through broader reporting obligations, we would encourage the CSA to continue their review of the efficacy of broader reporting requirements in the EU and Australia to determine whether the cost of broader reporting (to both those reporting and the regulators) is warranted given the potential deleterious effect of such reporting (as acknowledged in the Consultation Paper).

13. Are there additional or different regulatory or remedial provisions that could be considered to

[5] https://www.esma.europa.eu/sites/default/files/library/technical_advice_on_the_evaluation_of_certain_aspects_of_the_ssr.pdf
[6] Ibid., p.125

improve deterrence of problematic conduct? If so, what are these provisions?

As noted earlier in our letter, the CSA currently has tools that would allow it to address problematic conduct related to short selling and we are cautious that any regulatory or remedial provisions don't have a significant chilling effect on legitimate short-selling activities. However as noted above, the CSA could consider and undertake an analysis of a new provision that would create statutory civil liability with respect to a misleading or untrue statement (if such statement was made with a view to profit from a decrease in the share price of such issuer).

15. Is it important that a statement have actual market impact to trigger enforcement action by securities regulators?
a. Should another standard be used? For example, in your view is the "reasonable investor" standard a preferable approach (e.g., would a reasonable investor consider that statement important when making an investment decision)? If so, why? What are the potential implications of such a change?

As noted earlier, we believe that a different standard is inappropriate as the elimination of a market impact assessment and a materiality threshold can be expected to have a significant chilling effect on legitimate short selling activities. In our view, this standard is appropriate and a separate standard related to short selling only is not warranted especially due to a lack of empirical data and analysis related to the prevalence of 'short and distort' campaigns and their impact in Canada.

We appreciate the opportunity to provide the CSA with our views on this consultation. Please do not hesitate to contact the members of AIMA set out below with any comments or questions that you might have. We would be pleased to meet with you to discuss our comments and concerns further.

Yours truly,

ALTERNATIVE INVESTMENT MANAGEMENT ASSOCIATION CANADA

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