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March 24, 2021
VIA EMAIL

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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
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Re: CSA Consultation Paper 25-403 Activist Short Selling (the "Consultation Paper")

The Canadian Advocacy Council of CFA Societies Canada[1] (the "CAC") appreciates the opportunity to provide the following comments on the Consultation

[1] The CAC is an advocacy council for CFA Societies Canada, representing the 12 CFA Institute Member Societies across Canada and over 18,000 Canadian CFA Charterholders. The council includes investment professionals across Canada who review regulatory, legislative, and standard setting developments affecting investors, investment professionals, and the capital markets in Canada. Visit www.cfacanada.org to access the advocacy work of the CAC. CFA Institute is the global association of investment professionals that sets the standard for professional excellence and credentials. The organization is a champion of ethical behavior in investment markets and a respected source of knowledge in the global financial community. Our aim is to create an environment where investors' interests come first, markets function at their best, and

Paper. We have organized our comments into an introduction, a series of key points relating to our commentary and views, and responses to select Consultation Questions.

Introduction

As stakeholders who professionally function in this subject matter, we genuinely appreciate the analytical rigour, context, explanation, and the specialist dataset employed in the research and content of this Consultation Paper.

While some activities relating to activist short selling are problematic and justify further consideration of targeted regulatory response, we are of the strong view, supported by robust academic research and a global regulatory consensus, that short selling has important foundational purposes to a robust capital markets environment. These include critical contributions to market liquidity and price formation. As outlined in the Consultation Paper, short selling has inherent and asymmetric risks, as well as significant related borrowing costs to maintain short positions. We believe any incremental regulatory response to the problematic activities under discussion must target the problematic activities in isolation and not serve as any sort of general deterrent to short sellers, or to short selling generally. To do otherwise could have wide-ranging and systemic negative consequences for Canadian capital markets.

Key Points

1. The systemic capital markets benefit of a robust environment for short selling are well-established, and the protection of this critical market function should be paramount in the consideration of incremental regulation to address problematic behaviours under discussion.

2. Activist short sellers often contribute to market efficiency, and the problematic behaviours and activities under discussion demand regulatory solutions and sufficient deterrence regardless of the associated directional bias of the market participant employing them.

3. Policy and regulatory solutions must be grounded in robust analysis, and a complete picture of the transactional environment in which problematic behaviour or activity occurs. Episodic analysis of transactional data such as failed trades and securities lending activity is inherently problematic, and effort should be undertaken to make this transactional data a part of the ongoing remit of the regulators' market surveillance authority. Furthermore, the full scope of relevant transactional data and associated ongoing analysis should be an **integrated** resource available and configured to serve multiple regulatory purposes and

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functions across multiple regulatory agencies, such as enforcement and securities registrant conduct monitoring, in addition to its core purpose of market surveillance.

4. Securities regulators already possess remedies to address the problematic behaviours and activities under consideration. A robust and analytically evidenced case has not been presented that existing regulatory or statutory remedies could not be more robustly employed to deter problematic behaviours and activity. We caution consideration of specific incremental regulatory or statutory remedies, particularly those which would take deterrence into the realm of a private rights of action, when existing regulatory tools have not been fully tested or employed.

Responses to select Consultation Questions

1. *What is your perception about activist short sellers? Please describe the basis of that perception.*

The data included in the Consultation Paper seems to indicate that activist short sellers in the Canadian markets are generally attempting to contribute to market efficiency and identified overvaluation by doing such things as asking questions about inconsistencies in an issuer's disclosure record, asking questions about a reporting issuer's strategy and disseminating related information in support of these activities. The data would further suggest that these short sellers are not generally short-term opportunists, as the Consultation Paper notes that while 75% of targets had a negative price impact on the first day of the Campaign announcement (and up to one month afterward), the extent of the short-term price impact varied across targets and over time. We interpret from the data presented that many activist short sellers are legitimately attempting to improve price discovery and contribute to market efficiency in cases of overvalued securities.

Investors and capital markets generally benefit from a healthy discourse about securities of reporting issuers, and from the effects of the transactional activity that is used to reflect various market participants' views in this discourse (including short selling). As noted in the Consultation Paper, there are significant costs to shorting securities and an accompanying asymmetric risk profile that does not exist for long investors. It is important for the marketplace in aggregate to hold issuers accountable, sometimes through direct questioning and, where appropriate, the presentation and dissemination of data in support of these questions and related contradictory statements. A robust environment that encourages accountability and dialogue ensures efficient price formation and helps to balance a stakeholder environment in the marketplace that is already deeply implicitly supportive of issuers in ensuring maximal valuation for issuer securities, often without regard to fair or appropriate valuation considerations.

In our view, it is not appropriate to by-default hold issuers and short sellers, or other market participants that generally exist at arms-length to an issuer to the same standard of accuracy when making statements about an issuer. Insiders and representatives of an issuer will inherently have more information on the financial and business condition of the company than other market participants. Any policy discussion should not seek to equivocate the evidentiary burden of claims between those that have the underlying information, and those that seek incremental disclosure or clarity on the basis of questions or the dissemination of seemingly contradictory information.

While we recognize the impact of social media on financial markets is beyond the scope of the Consultation Paper, the prevalence of such tools raises the question of the need for a standardized definition of "dissemination", this time in the context of activist short selling activities. It may be unclear as to when a statement made through a social media platform amounts to a "public statement". While we surmise that statements released on platforms such as Twitter would be public, there are of course many more private platforms available to limited or subscribed audiences. Therefore, continued study of the nature and impact of statements made to smaller groups of individuals may be required. If the definition of "dissemination" or "public statement" is too broad, it could inadvertently curtail normal-course healthy discourse on the merits of issuers' securities, with potentially systemic consequences.

2. *Can you give examples of conduct in activist short selling Campaigns that you view as problematic?*

We understand from the data that most activist short sellers are generally not interested in maintaining anonymity, particularly those of a significant size, with market prominence and/or a good track record of effecting change. However, those engaging in certain types of sometimes-related problematic behaviour or activities may prefer to do so anonymously.

We believe there are instances where market participants (including activist short sellers) use potentially problematic tactics, such as publicly posing strategic questions to management during times such as quiet periods where management may not be in a position to fully respond to the inquiry. We believe it's also potentially problematic where statements are made that are intended to cast aspersions on an issuer or particular officers or directors that are inherently very difficult to disprove, such as with respect to governance matters as an example.

3. *Given the focus of the available data is on prominent activist short sellers, what is your view regarding less prominent activist short sellers or pseudonymous activist short sellers targeting Canadian issuers? How can they be identified? Is there any evidence that they are engaging in short and distort campaigns?*

We are of the view that phrases such as "short and distort" should be clarified, as it is commonly thought of as a type of securities fraud. The data presented does not

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indicate this is commonly problematic in the Canadian marketplace. However, we believe this could be the subject of further data-driven analysis, with the benefits of access to and collation of additional datasets (such as those described elsewhere).

As stated under the Key Points section, we would encourage analysis of securities lending data, both on a backwards-looking basis relating to specific activist short-selling situations that were found to be problematic, and the development of a similar ongoing regulatory monitoring capability. We believe that ongoing regulatory oversight of securities lending data in combination with existing regulatory tools could serve as a potentially useful deterrent for problematic behaviour and activities. This would allow for further analysis of the extent to which pseudonymous vs otherwise identified activist short sellers results in different outcomes for the issuers and market participants involved, and whether there is a particular or significant incidence of pseudonymous activity. Prima facie, we see anonymous or pseudonymous activity as potentially problematic, and deserving of consideration for further study and regulatory oversight.

4. *What empirical data sources related to Campaigns should we consider?*

As discussed, we encourage the development of additional regulatory oversight and transparency on an ongoing basis into securities lending activity and failed trades. We would encourage the review of the examined data sets with other short-specific and securities-lending related datasets (such as the datasets available from S3 Partners and other specialist/domain-specific vendors) for potential further insights, in combination with securities lending and trade-fail data with attribution from the marketplace.

While the empirical data and resulting analysis from this singular data set is limited to those campaigns identified by Activist Insight, which tracks campaigns by prominent activist short sellers but may not include similar activities undertaken by less prominent individuals or entities. It is indicated that Activist Insight considers a prominent activist to be those with a "history of disclosing strong thesis or reports, disclosing a position in the target company and having a considerable impact on the target's stock price". While we are not aware of any other alternative sources for similar identification of activist short selling activity or that of less prominent activist short selling activity, the question of whether all pertinent activity has been reviewed and analyzed remains and should be the subject of further research.

6. *Is there any specific evidence that would suggest that Canadian markets are more vulnerable to activist short selling, including potentially problematic activist short selling (e.g., size and type of issuers, industries/sectors represented or other market conditions)?*

a. *Please provide specific examples of these vulnerabilities, and how they differ from other jurisdictions.*

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It is specifically noted in the Consultation Paper that Canadian listed issuers may trade infrequently, and that the Canadian securities lending market is concentrated in securities of larger, more heavily traded issuers. The relative lack of liquidity and available securities for borrowing to US markets both serve as incremental deterrents to short selling generally, but particularly to activist short selling in Canada. As an aggravating factor in closely held or thinly traded issuers, insiders or significant holders may segregate positions from lending pools, further narrowing quantities available to be borrowed by potential short sellers. It would be helpful for further examination by regulators if they had regularized and ongoing transparency into securities lending transactions and inventories of shares that are available for lending, both widely across Canadian issuers, and particularly in issuers then subject to activist short selling campaigns. As a comparative example, the EU gathers related data under the Securities Financing Transaction Regulation (SFTR), requiring reporting of securities financing transactions, including securities lending or borrowing transactions, to a trade repository for advancing transparency in securities ownership, financing, and transactions.

We see no evidence of specific Canadian market vulnerability to activist short selling. We believe the environmental factors enumerated above serve as incremental deterrents to short selling generally, relative to other more liquid markets.

7. *Do issuers have practical limitations in terms of their ability to respond to allegations made in a Campaign? If so, what are these limitations, and do you have any recommendations on how to alleviate them?*

Issuers may be practically limited in their ability to respond to allegations made in a Campaign as a result of the time, effort, and potential for reputational impact on the issuer if the response is unsatisfactory. Issuers incur costs associated with outside consultants, lawyers and other advisors to assist with any response. Given the make-up of public markets in Canada, there are many smaller public issuers that may struggle to adequately resource the mounting of an appropriate defence.

Issuers may face the additional problem of open-ended lines of activist short seller inquiry that are not easily answerable within the scope of normal-course continuous disclosure. As an example, if an activist short seller were to generally suggest potential related-party conflicts in the supply chain of an issuer, this may not be entirely and positively disprovable without the release of significant numbers of contractual counterparties and these counterparties' ownership details – significantly beyond the scope of information typically viewed as material, and in many cases may be unavailable to the issuer for public disclosure.

8. *Are issuers reluctant to approach regulators when they believe that they are being unfairly targeted by an activist short seller? If so, why? If not, why not?*

The Consultation Paper notes that issuers may not wish to complain about problematic Campaigns because it may be seen as inviting a regulatory review or

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examination of their initial/continuing public disclosure record, and potentially of information relating to the claims or questions of the short seller that may otherwise (perhaps appropriately) not be part of their public disclosure record. Issuers who are not prepared to "defend" their actions, response (or lack thereof) to the short sellers' claim(s), or disclosure record for the practical limitations set out in our response to Question #7 above are unlikely in our view to approach regulators themselves.

We note that in 2015, the BCSC released BC Notice 2015/07 "Notice of results of research on HFT in the Canadian venture market", describing concerns raised by venture issuers. Among other things, these venture issuers believed that high frequency traders were having a negative impact on the venture market by conducting short selling activity after the release of positive news that limited the increase in the price of these issuers' securities. Ultimately the research that was conducted and the commissioned reports indicated that the data did not support the concerns raised by these issuers.

9. *Is the existing regulatory framework adequate to address the risks associated with problematic activist short selling? Please explain why or why not and provide specific examples of concerns and areas where, in your view, the regulatory framework may not be adequate.*

To the extent activities associated with activist short selling are problematic, we believe that the question of whether regulatory enhancement is required should be the subject of further study, and that regulatory oversight should be improved into failed trades and securities lending activity for a more holistic analysis of potentially problematic transactions and behaviours. Based on this analysis, incremental regulatory tools could be examined for adoption to deal with specific 'risks' sometimes associated with activist short selling. These risks are inclusive of the dissemination of unbalanced information or the deliberate release of false or misleading information. We note the evidentiary burden of proving that statements made are materially misleading or untrue in combination with a reasonable expectation of a significant effect on the market price or value of a security.

As noted in the Consultation Paper, there is no universal definition of "naked short selling", but we understand it generally means any short sale where the seller has not pre-borrowed the securities or established or have a reasonable expectation that they can borrow the securities needed for settlement. Naked short selling is generally not permitted, except by regulatory allowance for market makers that provide liquidity for that security.

In Ontario, there is connectivity between the subject matter of this Consultation Paper and the Final Report from the Ontario Capital Markets Modernization Taskforce (the "**Taskforce**") relating to short selling and its recommendations for regulatory and legislative changes. The report concluded that the current UMIR rules are not stringent enough to ensure that steps are taken by short sellers to confirm that adequate securities are available to settle their short trades. We also believe that the meaning of a

"reasonable expectation" to borrow may vary in practice and mechanically between market participants.

The Taskforce report notes that both the U.S. and the E.U. require either pre-borrow or positive locate requirements for short sales (as well as more prescriptive close-out or buy-in provisions for trades failing to settle). We believe that a regulatory requirement for a positive locate (confirming a mutually understood reasonable expectation of borrow) may be necessary for the Canadian markets as well for short sales, and not just those where there has been a prior extended failed trade. The Taskforce recommends in their report that UMIR require dealers to confirm the ability to borrow securities before accepting a short sale order, and that securities that are "easy-to-borrow" would be exempted from this requirement. We would support a similar CSA recommendation to revise UMIR.

We would also encourage greater regulatory visibility and oversight of the securities lending markets and failed trades such that robust ongoing analysis can be performed relating to potential policy change. We believe that the policy discussion relating to failed trades is not well-served by dated and episodic analyses of data.

10. *Have there been market developments or new information since 2012, when UMIR amendments regarding short selling and failed trades were implemented, that would warrant revisiting the existing regulatory framework for short selling? If so, please describe these new developments or information and indicate, providing evidence to support your views:*

a. whether, in your view, there is a connection between failed trades and activist short selling;

We have not seen nor are we aware of any evidence to support a robust connection between failed trades and activist short selling, though believe that the degree of regulatory oversight and transparency into failed trade activity and securities lending activity is in need of systemic improvement for further analysis.

c. whether there are relevant regulatory requirements in other jurisdictions that should be considered and why.

As noted above, the EU is currently ahead of Canada with respect to transparency of securities lending and borrowing activity as a result of its adoption of Securities Financing Transaction Regulation (SFTR). We believe it is important we continue to pursue incremental transparency in our capital markets and build a regulatory market oversight regime where our regulators can easily analyze all transactional activity including securities lending transactions, and more easily identify those market participants that are participating in problematic or manipulative capital markets activity.

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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;

The Consultation Paper notes that ESMA requires disclosure of net short positions of natural or legal persons be made to the regulator at 0.2%, and publicly disclosed if the position reaches 0.5% of the issued share capital of a company. We are supportive directionally of the regulatory disclosure aspects of this policy, though believe that the materiality thresholds are deserving of further study in the Canadian context. We believe regulatory disclosure of significant short positions in combination with regulatory oversight of securities lending activity and failed trades could help deter those short sellers with intent to mislead or manipulate the market. We believe public disclosure of short positions would likely serve as an untargeted and incremental deterrent to all short sellers, particularly in the challenged liquidity environment of Canadian markets. We believe transparency to regulators may sufficiently deter those with intent to mislead or manipulate, without imposing an incremental deterrent to all short sellers generally.

Any requirements for public disclosure may also result in market participants attempting to avoid disclosure at the enumerated thresholds through the use of synthetic transactions and related strategies. We would again highlight the asymmetric risks and carrying costs of a short position relative to a comparably sized long position, and the inherent disincentive this already creates. Care needs to be taken that additional disincentive(s) to taking short positions (such as requirements to disclose at thresholds and/or associated duties to update) do not detract from the incentives for the important and additive function of short selling broadly or systemically. Any regulatory responses should be targeted to the problematic activity in specific terms, rather than short selling in more general terms where the related activity or behaviour of the market participant is not of concern.

b. what should be the trigger and the timing of any additional disclosure;

We believe the case has not been firmly established for public disclosure of short positions, and that regulators should focus on gaining transparency into transactional and position data for regulatory purposes and further study, including securities lending data. Any thresholds for public disclosure should be studied within the specific Canadian context, and subject to a robust cost-benefit analysis.

c. how can additional disclosure be meaningful without negatively impacting market liquidity; and

It may be difficult to require additional disclosure without first studying the Canadian liquidity environment, underlying data, and the potential impact of these

disclosures, and then by defining the form in which such disclosure must take place. Additional disclosure in a form similar to that required by National Instrument 62-103 - *The Early Warning System and Related Take-Over Bid and Insider Reporting* outside of the alternative monthly reporting system could be useful models for potential forms of disclosure if merit was to be found in requiring these disclosures.

d. do you foresee any issues with imposing a duty to update once there has been a voluntary disclosure of a short position?

We question whether such a duty would add further deterrent to short selling generally rather than deterring specifically problematic activities.

12. *In your view, do the existing enforcement mechanisms adequately deter problematic activist short selling? If so, why? If not, why not?*

We see no evidence that the existing mechanisms are insufficient, though believe they could be more robustly employed, particularly in combination with greater access to complementary data regarding market activity and securities lending.

a. Can deterrence be improved through specific regulation of activist short sellers? If so, how?

We are not of the view that activist short sellers should be subject to specific incremental regulation. Where problematic behaviors are associated with a specific instance of or market participant related to an activist short selling Campaign, those behaviors should be targeted with robust regulatory response and incremental regulation where required.

With that said, we do not believe the existing enforcement activity adequately deters some of these problematic activities sometimes associated with activist short selling. It is possible that examining the incremental enforcement tools and resources that have been set up in other jurisdictions could be additive, as would more robust usage of existing regulatory and enforcement tools in instances of problematic behaviour, particularly in combination with additional data sources. We understand that projects have already been undertaken in Canada to bolster market surveillance and the real-time trade data available to regulators. This should be reinforced with ongoing and collaborative access to securities lending, failed trades, and associated data and analysis between regulators, stronger integration between market surveillance and enforcement functions, equality of access to data and analysis between regulatory silos, stronger and more robustly employed enforcement tools, and additional enforcement resources.

We recognize that securities legislation prohibits fraud and market manipulation by prohibiting persons from engaging in acts that the person knows (or reasonably ought to know) results in or contributes to a misleading appearance of trading activity or an

artificial price for a security or that perpetrates a fraud. Despite these prohibitions, the record of enforcement activity relating to these provisions is not strong, and may not serve currently as an effective deterrent. We note that there can be a significant lag time for enforcement to gather sufficient data and evidence to pursue an enforcement case of fraud or market manipulation. During this time, harm or manipulative activity can continue. Where required to prove materiality, it has also been historically difficult to prove that a statement has been materially misleading.

Absent those rare instances where a market participant intentionally and clearly issuing false statements whether to support a short or long investment position with clear market impact, the time it takes for regulators to gather the information required and then bring a case is long. We believe regulators need the data, enforcement resources, personnel, and tools to enable them to triage issues quickly and concentrate resources on cases of problematic activity or behaviour.

13. Are there additional or different regulatory or remedial provisions that could be considered to improve deterrence of problematic conduct? If so, what are these provisions?

We believe that additional data-driven examination of incremental statutory and regulatory tools should continue, as if there was a standard across the country prohibiting misleading statements about a reporting issuer, many of the concerns raised in the Consultation Paper might be pre-empted.

In Ontario, the Taskforce has also noted that unsubstantiated statements are a problem for both short selling and trading on the long side. It recommended a prohibition on making misleading or untrue statements about public companies in order to combat practices intended to affect security prices or influence investment decisions. The Taskforce recommended that proof of market distortion not be required, but simply the intent to impact the market or influence a reasonable investor's decision-making.

As set out in the Consultation Paper, this is similar to the approach in British Columbia to prohibitions on misleading statements and the provision of false information by those engaged in promotional activities. We believe that in the context of activist short selling, the approach could be preferable to existing securities legislation with respect to misrepresentations that requires proof that the statements are materially misleading or untrue and are reasonably expected to have a significant effect on the market price or value of a security. We reiterate, however, the concerns raised previously that activist short sellers (and other market participants without access to non-public information on an issuer) should not be held to any standard resembling that of company insiders, and clarity will be needed regarding what constitutes a 'public statement' about an issuer.

The Consultation Paper describes some proposals in other jurisdictions to address problematic short selling, including one proposal for a 10-day holding period applicable to stock promoters or short sellers who open large positions and disseminate

market-moving information, so that the market has an opportunity to evaluate the credibility of the information. We would not be supportive of a proposal of this nature, as we believe it would tacitly amount to a ban on all activist short selling by introducing a major incremental deterrent, without any targeting to problematic activities sometimes associated with activist short selling. We believe the potential risks to the short-seller over such a period of time might be too great to justify the activity, particularly given the vulnerability of the position in the challenged liquidity environment of Canadian capital markets and to other market participants. We also believe that such a restriction might be difficult to enforce in the context of discretionary asset management mandates.

14. Can you provide examples of specific activist short selling conduct that in your view is problematic but may not fall within the scope of existing securities offences such as market manipulation and misrepresentation/misleading statements? In your view, how should this problematic conduct be addressed by regulators?

Some of the activist short selling conduct that may be problematic, yet not amount to market manipulation and misrepresentation include the following:

- Making statements with anonymity or intentionally obfuscating the identity of the person/company releasing the statements;
- Casting non-specific or open-ended accusations against an issuer or management that are difficult to defend against or disprove;
- Making statements with manipulative intent, such as when a contingent or closing order is already placed in market when the information is disseminated; and
- Targeting an issuer when the issuer can not respond such as during a quiet period or when the statement is related to a pending material change announcement such as an M&A transaction that can not be publicly disclosed.

We believe the foregoing activities should be examined for specific policy responses and amendments to existing regulation and enforcement tools which are well-suited to address these issues. It is possible that existing securities regulation or offences could be modified to explicitly capture the above activities without the need for new overreaching regulation or offences that could stifle and deter short selling activity generally. For example, these types of activity could be contributively indicative (though not determinative) of manipulation or intent to mislead, as applicable.

15. Is it important that a statement have actual market impact to trigger enforcement action by securities regulators?

We are not of the view that statements necessarily need have actual market impact to trigger enforcement action. The intent behind the statement should be the differentiating or contributing factor, as the effect on the market can be difficult to judge and be impacted by exogenous factors or events when the conduct and intent of the person releasing the statement is no less objectionable.

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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?

While market impact may be an existing and important factor in triggering an enforcement action, we don't believe that it should be the decisive element in whether a regulatory investigation or action is commenced. Realized market impact is subject to innumerable exogenous influences in isolated observation, and further suffers from subjective analytical judgments. The content and context of the statement made should be of primary importance. We agree that a 'reasonable investor' approach (if properly designed and defined) might be preferable and is deserving of further study.

Furthermore, we believe there's a significant need for examination of the tools and resources with which regulators are equipped to monitor for misleading statements. We understand that analytical tools are unsophisticated relative to tools in language and semantic analysis being regularly and widely deployed for commercial purposes in capital markets. Changing regulatory oversight standards and datasets should give rise to an expedited and integrated implementation of tools (accompanies by sophisticated human resources) to effectively deter problematic behaviors by market participants generally, and not just those associated with activist short selling.

Concluding Remarks

We thank you for the opportunity to provide these comments and would be happy to address any questions you may have. Please feel free to contact us at cac@cfacanada.org on this or any other issue in future.

(Signed) *The Canadian Advocacy Council of*
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