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Rule Connection: UMIR/IDPC Rules

Division: Investment Dealer

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Proposed Amendments Respecting Mandatory Close-Out Requirements

Executive Summary

Comments Due By: April 10, 2025

The Canadian Investment Regulatory Organization (**CIRO**) is proposing amendments to the Universal Market Integrity Rules (**UMIR**) and Investment Dealer Partially Consolidated Rules (**IDPC**) that would require applicable Dealer Members that are Investment Dealers (**Investment Dealer Members**) to:

- close out a fail-to-deliver position in the event of a settlement failure in a listed security at the recognized clearing agency by specified timelines by buying or borrowing shares,
- pre-borrow the affected security where there has been a failure to close out by specified timelines for all future short sales in the security at issue,
- provide certain reporting and notifications in connection with mandatory close-out requirements, and
- have a reasonable expectation to settle on settlement date for Investment Dealer Members that are not Participants under UMIR (**Proposed Amendments**).

CIRO is publishing the Proposed Amendments in order to solicit comments on the best approach to:

- introduce mandatory close-out requirements to reduce fail-to-deliver positions involving securities with persistent failures to deliver, and
- establish a reasonable expectation to settle a trade on the expected settlement date for Investment Dealer Members that are not Participants.

How to Submit Comments

Comments on the Proposed Amendments should be in writing and delivered by Thursday April 10, 2025 (90 days from the publication date of this Bulletin) to:

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A copy should also be delivered to the Canadian Securities Administrators (**CSA**):

Trading & Markets Division Ontario Securities Commission 22nd Floor 20 Queen Street West, Toronto, Ontario, M5H 3S8 e-mail: tradingandmarkets@osc.gov.on.ca	**Capital Markets Regulation** B.C. Securities Commission P.O. Box 10142, Pacific Centre 701 West Georgia Street, Vancouver, British Columbia, V7Y 1L2 e-mail: CMRdistributionofSROdocuments@bcsc.bc.ca

Commenters should be aware that a copy of their comment letter will be made publicly available on the CIRO website at www.ciro.ca.

Table of Contents

1. Background

A number of stakeholders have recently raised the need to introduce mandatory close-out provisions in Canada. In January 2021, the Ontario Capital Markets Modernization Taskforce (**Taskforce**) issued its Final Report which recommended the modernization of Ontario's short selling regime. The Final Report indicated that Ontario's short selling regime stands in contrast to other jurisdictions such as the U.S., where there are mandatory close-out provisions in place. Part of the Taskforce's recommendations included the adoption of mandatory buy-in requirements by CIRO.

In December 2022, CIRO and the CSA published our Joint CSA/IIROC Staff Notice 23-329 Short Selling in Canada to request public feedback on Canada's short selling regulatory framework. We received 23 comment letters. A number of commenters supported introducing mandatory buy-ins or close-outs of short positions, similar to rules in place in the U.S. and adopted but not yet in force in the European Union.

In November 2023, CIRO and the CSA published our joint response[1] to the comments received. In our response, we indicated that the CSA and CIRO would form a staff working group to more broadly examine short selling issues in the Canadian market context, beginning with an analysis of potential mandatory close-out or buy-in requirements.

As a result, CIRO and the CSA struck a staff working group in January 2024. Since then, CIRO staff have been working with the CSA to review whether additional requirements relating to short selling, including mandatory close-out provisions, would be appropriate in the Canadian context. CIRO and the CSA have heard concerns of persistent failures to settle and that the current voluntary buy-in procedures in Canada are too lax and could contribute to a negative perception of capital markets in Canada, which in turn could deter otherwise interested parties from listing or investing in Canada. Based on our analyses at this time, CIRO and the CSA are of the view that proposing a mandatory close-out requirement would be helpful to Canadian regulators to better understand if this approach would be appropriate to strengthen our regulatory framework.

Therefore at this time, CIRO is publishing the Proposed Amendments for comment.

2. Proposed Amendments

We propose to structure mandatory close-out requirements to align with similar requirements under Rule 204 of Regulation of Short Sales (**Regulation SHO**) in the U.S. Based on our consultation with certain stakeholders to date, we have heard that this would facilitate increased efficiencies and contribute to a level playing field among Investment Dealer Members that trade in both markets. As some entities in the industry may already be familiar with U.S. requirements, modeling close-out requirements on U.S. rules may have less of an impact on Investment Dealer Members that trade securities that are inter-listed in the U.S. There are also similarities between the settlement processes in the U.S. and Canada. As a result, most elements of the Proposed Amendments are harmonized with the mandatory close-out requirements in Rule 204 of U.S. Regulation SHO where appropriate.

[1] Joint CSA/CIRO Staff Notice 23-332 Summary of Comments and Responses to CSA/IIROC Staff Notice 23-329 Short Selling in Canada.

We believe that this approach could achieve the regulatory objective of reducing persistent failures to settle while minimizing negative impacts on the industry where possible. This is because basing mandatory close-out requirements on fail-to-deliver positions at the recognized clearing agency:

- would be consistent with current settlement practices and procedures in Canada.

  The recognized clearing agency in Canada is the Canadian Depository for Securities Limited and CDS Clearing and Depository Services Inc. (**CDS**). Similar to the National Securities Clearing Corporation (**NSCC**) in the U.S., CDS also clears and settles trades through the Continuous Net Settlement (**CNS**) process, which nets the securities delivery and payment obligations of all of its members.

- has proven to be effective in reducing settlement failures in the U.S.

  Regulation SHO became effective in the U.S. in June 2004. At that time, the majority of trades in the U.S. settled on time. The NSCC indicated that on an average day, only approximately 1% (by dollar value) of all trades failed to settle on time.[2] This trade failure rate is similar to what we are currently experiencing in Canada.

  After the implementation of a temporary mandatory close-out provision in Rule 204T (predecessor to Rule 204) in the U.S., the SEC's Office of Economic Analysis indicated that the average daily number of fails-to-deliver for equity securities declined from 1.1 billion to 478 million for a total decline of 56.6 percent.[3] These improvements led the SEC to adopt mandatory close-outs as a permanent requirement, resulting in Rule 204 of Regulation SHO.

2.1 Requirement to Close out or Allocate

Investment Dealer Members that have sold shares in a listed security on a marketplace must deliver those shares by settlement date. Under the Proposed Amendments, Investment Dealer Members that are members of a recognized clearing agency[4] (**Clearing Members**) that are unable to deliver sufficient shares on settlement date to the recognized clearing agency (**fail-to-deliver position**) would need to close out that position within the timelines set out below. Fail-to-deliver positions would be specific to each Clearing Member and reflect the daily outstanding position in each listed security after the netting of the Clearing Member's delivery and payment obligations through the CNS system. The Clearing Member would be required to close out a fail-to-deliver position by:

- purchasing or borrowing shares until the fail-to-deliver position has been reduced to a net flat or net long position at the recognized clearing agency, or

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[2] See Rule 204 Adopting Release No. 34-60388

[3] See Rule 204 Adopting Release No. 34-60388

[4] We propose to define a "recognized clearing agency" in subsection (1) of IDPC Rule 4781 to mean an acceptable clearing corporation that is recognized by the applicable securities regulatory authorities in Canada for the clearing and settling of trades in listed securities. At the time of writing, there is only one recognized clearing agency, being The Canadian Depository for Securities Limited and CDS Clearing and Depository Services Inc.

- allocating all or a portion of the fail-to-deliver position to another Investment Dealer Member (**Allocated Member**) for which it clears or settles trades. Allocated Members would then become responsible for closing out the allocated fail-to-deliver position by purchasing or borrowing shares until the fail-to-deliver position has been reduced to a net flat or net long position at the recognized clearing agency.

When closing out a fail-to-deliver position

Where a Clearing or Allocated Member purchases shares on a marketplace to close out a fail-to-deliver position, we expect that these purchases would be executed under reasonable commercial terms that would not be prejudicial to the maintenance of a fair and orderly market. To minimize market disruption, we propose that Clearing or Allocated Members:

- would not be required to purchase securities at a price that is greater than a certain premium to the current market price when executing their trades on a marketplace to close out a fail-to-deliver position. We are asking for feedback on this issue in Question 6 of this Bulletin and will take the comments into consideration when determining the appropriate guidelines for the premium; and
- may also borrow securities as an alternative to purchasing shares on a marketplace to satisfy the close-out requirement.

Allocations must be reasonable and timely

Clearing Members would have the ability to allocate all or a portion of a fail-to-deliver position to an Investment Dealer Member for which it clears or settles trades, as long as these allocations are made in a reasonable and timely manner:

- allocations must be reasonable in that the Clearing Member must have books and records in place to support the identification of a specific Investment Dealer Member whose trading activities caused the fail-to-deliver position, and
- allocations must be made in a timely manner as the Allocated Member would need to close out within the required timelines. The act of making an allocation itself does not extend the close-out timeline to close out, which is calculated from settlement date (or in the case of deemed to own securities as described below, the close-out timeline is calculated from trade date).

If a Clearing Member does not have the processes or books and records in place to support a reasonable and timely allocation, the Clearing Member would remain subject to the close-out requirement.

2.2 Timelines for Closing out

Clearing or Allocated Members would be required to close out a fail-to-deliver position that resulted from a sale by no later than the trading day after settlement date, being S+1. This would also be the default close-out timeline for all sales where the Clearing or Allocated Member is not able to demonstrate on its books and records that the fail-to-deliver position resulted from one of the exemptions provided below. This default close-out timeline would also apply to fail-to-deliver positions

that resulted from a sale that is marked as a short-marking exempt[5] (**SME**) order on the marketplace, except where the SME order relates to trading by a person with Marketplace Trading Obligations acting in their security of responsibility.

2.2.1 Long Sales

If a Clearing or Allocated Member can demonstrate on its books and records that its fail-to-deliver position resulted from a long sale, the Clearing or Allocated Member would be required to close out the fail-to-deliver position by no later than the third consecutive trading day after settlement date, being S+3.

2.2.2 Persons with Marketplace Trading Obligations

If a Clearing or Allocated Member can demonstrate on its books and records that its fail-to-deliver position is attributable to transaction(s) by a person with Marketplace Trading Obligations when acting in their security of responsibility, the Clearing or Allocated Member would be required to close out the fail-to-deliver position by no later than the third consecutive trading day after settlement date, being S+3.

2.2.3 Deemed to Own

If a Clearing or Allocated Member can demonstrate on its books and records that its fail-to-deliver position resulted from the sale of a security that the Clearing or Allocated Member (or the client that they are acting for) is deemed to own, the Clearing or Allocated Member would be required to deliver the security as soon as all restrictions on delivery have been removed, and in any case by no later than thirty-five calendar days after trade date.

Under the Proposed Amendments, a seller is deemed to own a security if they have complied with one of the following conditions, either directly or through an agent or trustee:

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[5] A "short-marking exempt order" is defined in section 1.1 of UMIR to mean an order for the purchase or sale of a security from an account that is:
(a) an arbitrage account;
(b) the account of a person with Marketplace Trading Obligations in respect of a security for which that person has obligations;
(c) a client account, non-client account or principal account:
(i) for which order generation and entry is fully-automated, and
(ii) which, in the ordinary course, does not have, at the end of each trading day, more than a nominal position, whether short or long, in a particular security;
(d) a principal account that has acquired during a trading day a position in a particular security in a transaction with a client that is unwound during the balance of the trading day such that, in the ordinary course, the account does not have, at the end of each trading day, more than a nominal position, whether short or long, in a particular security; or
(e) a principal account for a Participant that has:
(i) Marketplace Trading Obligations in respect of an exempt Exchange-traded Fund, or
(ii) entered into an agreement for the continuous distribution of an Exempt Exchange-traded Fund;
if the order is for the Exempt Exchange-traded Fund security or one of its underlying securities to hedge a pre-existing position in the Exempt Exchange-traded Fund security or one of its underlying securities and in the normal course, the account does not have, at the end of each trading day, more than a minimal exposed risk.

(a) purchased or entered into an unconditional contract to purchase the security, but has not yet received delivery of the security;

(b) owns another security that is convertible or exchangeable into that security and has tendered such other security for conversion or exchange or has issued irrevocable instructions to convert or exchange such other security;

(c) has an option to purchase the security and has exercised the option;

(d) has a right or warrant to subscribe for the security and has exercised the right or warrant; or

(e) has entered into a contract to purchase a security that trades on a when issued basis and such contract is binding on both parties and subject only to the condition of issuance or distribution of the security.

In these scenarios, it is possible that the seller has fulfilled a condition as set out above, but the security may not be in the physical possession of the seller at the time of the execution of the trade due to administrative delays that are outside of the seller's control. Therefore, we propose to include the same extended close-out timeframe as Regulation SHO, meaning that the seller must deliver the security as soon as all restrictions on delivery have been removed, and in any case by no later than thirty-five calendar days following trade date (T+35).

Additionally, UMIR Policy 2.2, UMIR 3.3 and proposed IDPC Rule 4782 each impose a reasonable expectation to settle a trade. For consistency, we also propose to amend these provisions to reflect the deemed to own exemption. Rather than requiring a reasonable expectation to settle on settlement date, in the case of deemed to own securities we would expect the seller to have a reasonable expectation to deliver the security as soon as all restrictions on delivery have been removed, and in any case by no later than thirty-five calendar days after trade date.

2.3 Consequences for Failing to Close Out

Failure to close out within the required timelines by the Clearing or Allocated Member would trigger pre-borrow requirements for all future short sales in the security at issue, including when:

- the Clearing Member is trading for its own account or for any of its clients, or
- the Allocated Member is trading for its own account or for any of its clients.

The pre-borrow restrictions would continue for the affected security until the Clearing or Allocated Member has closed out the position by purchasing or borrowing shares such that they are able to demonstrate they have a net long or net flat position on their books and records. Pre-borrow restrictions would also apply to any trade resulting from a short sale for an account where the order is marked as SME on the marketplace.

2.4 Reporting and Notification Requirements

To facilitate the operation and oversight of a mandatory close-out framework in Canada, we are proposing four requirements relating to reporting and notification as set out below. We are asking for feedback on the feasibility and appropriate information for such reporting under Question 9 of this

Bulletin. Once finalized, we expect to provide further details on reporting in guidance. The reported information would be used for regulatory purposes only and would not be publicly disseminated.

2.4.1 Allocation Reporting by Clearing Member

Where a Clearing Member has made a reasonable and timely allocation to an Allocated Member, we propose to require the Clearing Member to provide an allocation report to CIRO that, at a minimum, would include the following information:

- identity of Clearing Member
- identity of Allocated Member
- date of allocation
- details of the fail-to-deliver position that has been allocated, including security and volume.
- applicable trade date(s) and close-out date(s) associated with the allocated position.

We would expect Clearing Members to submit allocation reports directly to CIRO. The purpose of requiring allocation reports is to help facilitate the surveillance of fail-to-deliver positions by CIRO. These reports would allow CIRO to follow up directly with the Allocated Member for the allocated fail-to-deliver positions, rather than having to reach out to the Clearing Member to obtain information about the allocation.

2.4.2 Notification of Failure to Close out

2.4.2.1 By Clearing Member to Clients that are Investment Dealer Members

We propose to require Clearing Members to notify their clients that are Investment Dealer Members if the Clearing Member has failed to close out on time, and also when the purchase or borrow of securities has been made to close out the position. The purpose of these notifications is to inform Investment Dealer Members that use the Clearing Member for clearing and settlement of trades that they will become subject to pre-borrow restrictions for future short sales in the affected security until the fail-to-deliver position has been closed out by the Clearing Member. We would also require the Clearing Member to provide a copy of these notifications to CIRO, which would assist with our monitoring and surveillance efforts.

2.4.2.2 By Allocated Member to Clearing Member

We propose to require Allocated Members to notify their Clearing Member if the Allocated Member has failed to close out the allocated fail-to-deliver position on time, and also when the purchase or borrow of securities has been made to close out the position. The purpose of these notifications is to inform the Clearing Member that the Allocated Member will become subject to pre-borrow restrictions for future short sales in the affected security until the fail-to-deliver position has been closed out by the Allocated Member. We would also require the Allocated Member to provide a copy of these notifications to CIRO, which would assist with our monitoring and surveillance efforts.

2.4.2.3 By Clearing Member or Allocated Member to Trading Dealer

Where the Clearing or Allocated Member uses another Investment Dealer Member to execute trades on a marketplace (**trading dealer**), we propose to require the Clearing or Allocated Member to notify the trading dealer if the Clearing or Allocated Member fails to close out on time and becomes subject to pre-borrow restrictions, and also when the purchase or borrow of securities has been made to close out the position. The purpose of these notifications is to inform the trading dealer that the Clearing Member or Allocated Member will become subject to pre-borrow restrictions for future short sales in the affected security until the fail-to-deliver position has been closed out by the Clearing or Allocated Member. We would also require the Clearing or Allocated Member to provide a copy of these notifications to CIRO, which would assist with our monitoring and surveillance efforts.

2.5 Reasonable Expectation to Settle for all Investment Dealer Members

In addition to mandatory close-out requirements, we also propose to extend the requirement for a reasonable expectation to settle trades that resulted from an order to sell a listed security to all Investment Dealer Members. Currently only Participants and Access Persons under UMIR are required to have a reasonable expectation to settle a trade on settlement date, however Participants may be executing trades for another Investment Dealer Member that is not subject to the same requirement. Extending this requirement to all Investment Dealer Members would help ensure there is no regulatory gap so that the pre-trade requirement for a reasonable expectation to settle applies consistently to sales executed by all Investment Dealer Members. The extension of the requirement to have a reasonable expectation to settle becomes particularly important when an executing Participant relies on an originating Dealer Member that is not a Participant to have an expectation to settle that is reasonable.

Where a seller is deemed to own a security as described in subsection 2.2.3 above, rather than requiring an Investment Dealer Member to have a reasonable expectation to settle on settlement date, in these cases we would require that the Investment Dealer Member must be reasonably informed that the seller has a reasonable expectation to deliver the security:

- as soon as all restrictions on delivery have been removed, and
- in any case by no later than thirty-five calendar days after trade date (T+35).

In section 4 of Guidance Note GN-URPart3-24-0002, we provided guidance on the requirement to have a reasonable expectation to settle for Participants and Access Persons, which would also apply to Investment Dealer Members that are not Participants, such as:

- setting out factors that would affect the ability to have a reasonable expectation to settle, including client history and the presence of prior failed trades
- examples of how an Investment Dealer Member can have a reasonable expectation to settle
- what happens if there is no reasonable expectation to settle.

3. Alternative Considered - Mandatory Close-out Requirements as a Conduct Rule

We considered structuring mandatory close-out provisions as a type of conduct requirement rather than one that focuses on fail-to-deliver positions at the recognized clearing agency. A conduct rule would require that Investment Dealer Members close out each individual failed trade as executed on a marketplace where there has been no delivery of securities on the expected settlement date, regardless of whether this results in a settlement failure at the recognized clearing agency (through netting and novation). This would set a different trigger to initiate a close-out as compared to the Proposed Amendments, which focus on a fail-to-deliver position that would only be created where there is a CNS settlement failure at the recognized clearing agency. A conduct rule would impose a different standard than what is currently required under Rule 204 of Regulation SHO. Accordingly, we concluded that a conduct rule would not meet our objective of aligning with the U.S. requirements where possible.

At this time, we are not proposing to structure mandatory close-out provisions as a type of conduct requirement for the reasons set out below.

3.1 Reasons for rejecting alternative

Higher difficulty and costs in identifying individual trades to close out

Focusing on individual failed trades where there may be no fail-to-deliver position at the recognized clearing agency would be significantly more complex and resource-intensive to implement. For example, one order could have multiple partial fills across several days on a marketplace, and each fill could trigger a separate close-out timeframe that would need to be managed and tracked.

Increasing burden on Investment Dealer Members and Potential Conflict with Existing Settlement System

To date, we have not identified any other jurisdiction that has implemented an approach to close-out requirements that is similar to a conduct requirement where the focus is on individual failed trades. Therefore, it may be unlikely that Investment Dealer Members would be able to leverage any existing infrastructure to facilitate closing out individual trades as executed on a marketplace. Investment Dealer Members may need to build new systems and processes to ensure compliance, which could impose disproportionate burdens and challenges, especially on smaller or regional Investment Dealer Members.

Since a potential violation of the conduct rule could also be related to a trade failure at the recognized clearing agency, we have heard concerns that a conduct requirement could create a risk of Investment Dealer Members needing to close out the same failure twice, as the CIRO requirement would operate outside of existing settlement processes at the recognized clearing agency. This could create potential conflicts between the new conduct rule and existing processes at the recognized clearing agency, as these two processes would run independently of each other and be administered separately. It may be difficult for Investment Dealer Members to reconcile these processes, which could impose duplicative efforts on Investment Dealer Members regarding the same transactions.

For the reasons set out above, we are proposing not to proceed with structuring mandatory close-outs as a conduct requirement at this time.

3.2 Comparison with Other Jurisdictions

In addition to the U.S., we also reviewed mandatory buy-in or close-out requirements in other jurisdictions, as set out below.

3.2.1 European Union

Background

The European Union (**EU**) regime that requires mandatory buy-ins of trades that have failed to settle is part of a broader framework known as the Central Securities and Depositories Regulation (**CSDR** or **Regulation (EU) No 909/2014**).[6] The rules on the mandatory buy-in requirements are contained in Article 7 of the CSDR and the operational details of the buy-in process were detailed in the Commission Delegated Regulation (EU) 2018/1229 with regard to regulatory technical standards on settlement discipline (**Regulation (EU) 2018/1229**)[7] supplementing Regulation (EU) No 909/2014. The entry into force of the entire Regulation (EU) 2018/1229, initially scheduled for September 2020, was delayed twice, first until February 2021 and then until February 2022, when it became effective. However, in June 2022, the mandatory buy-in provisions of Regulation (EU) 2018/1229 were suspended until at least November 2, 2025.[8]

Reasons for delay

Initially, Regulation (EU) 2018/1229 was delayed due to concerns about the broader impact of settlement discipline provisions in CSDR on a variety of stakeholders, particularly with respect to IT resources, testing and adjustments to various legal arrangements. The impact of the COVID-19 pandemic resulted in further delays, as most IT resources were being deployed to ensure business continuity in work-from-home arrangements.

The decision to further delay (until November 2, 2025) provisions of Regulation (EU) 2018/1229 relating to mandatory buy-ins had several contributing factors, including the fact that the European Commission had begun a process of reviewing the CSDR more generally. The feedback received as part of that review showed significant stakeholder concern with the mandatory buy-in provision, with this aspect receiving the largest number of comments.

Concerns Raised

There were many concerns raised by stakeholders in relation to mandatory buy-in provisions that can generally be categorized as follows. Mandatory buy-ins may, or are likely to:

- Reduce market liquidity, especially in less liquid securities
- Reduce the willingness of providers of liquidity to participate

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6 The latest version of CSDR came into effect in January 2024.

7 Commission Delegated Regulation (EU) 2018/1229 of 25 May 2018 supplementing Regulation (EU) No 909/2014 of the European Parliament and of the Council with regard to regulatory technical standards on settlement discipline (Text with EEA relevance.)

8 For more details, please refer to ESMA's report on suspending the application of mandatory buy-in requirements Also, please refer to the amendments to the Commission Delegated Regulation formally postponing the application of the mandatory buy-in regime

- Increase costs to investors through wider spreads
- Negatively impact securities lending and repo markets.

Revised CSDR

As a result of the broader review of the CSDR noted above, and particularly in response to the issues raised, the EU revised the CSDR, and the amended framework came into force in January 2024.[9] While the mandatory buy-in provisions are still included as part of the framework, there are significant additional conditions that must apply before any implementation of the provisions:

- The European Commission must consider the mandatory buy-in provisions to be a "necessary, appropriate and proportionate" means to address the level of settlement failures in the EU;
- The application of other mechanisms of the CSDR (notably financial penalties) must be shown to have not reduced settlement failures or maintained a low level of failures; and
- The level of settlement failures has or is likely to have a negative effect on the financial stability of the EU.

Specific Provisions of Mandatory Buy-In Provisions

While it is not clear if or when the buy-in provisions would be implemented, the revised CSDR sets out some details of the expected process.

Obligation to Close Out

Responsibility for the buy-in depends on what entity clears the transaction. The specifics are as follows:

- Where a transaction is cleared by a central counterparty (**CCP**), the CCP executes the buy-in for all transactions cleared by that CCP
- For transactions not cleared by a CCP, but executed on a trading venue, the trading venue must have rules that impose an obligation on its members and participants to apply the buy-in process
- For all other transactions, a central securities depository (**CSD**) must have rules that impose an obligation for their participants to be subject to the buy-in provisions

These requirements are different than the close-out requirements under Regulation SHO, where the participant of a registered clearing agency is responsible for the close-out unless the failing position is allocated to a broker or dealer.

Timing of Close Out

Where a failing participant has not delivered securities within 5 business days after expected settlement date[10] (referred to as the "extension period"), the buy-in process commences. Depending on asset type

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9 Regulation (EU) 2023/2845 of the European Parliament and of the Council of 13 December 2023 amending Regulation (EU) No 909/2014 as regards settlement discipline, cross-border provision of services, supervisory cooperation, provision of banking-type ancillary services and requirements for third-country central securities depositories and amending Regulation (EU) No 236/2012 (Text with EEA relevance)

10 Expected settlement in the EU is currently T+2.

and liquidity, the extension period may be increased to a maximum of 7 business days. Additionally, where the failing transaction relates to a small and medium sized enterprise (**SME**) traded on a SME Growth Market, the extension period is 15 business days. The failing position must be delivered within an "appropriate timeframe" to be determined by the European Securities and Markets Authority (**ESMA**).

ESMA is responsible for developing several standards that set out the specific details of the buy-in process, including appropriate timeframes that take into account the asset type and liquidity of the financial instrument and the circumstances under which the extension period could be prolonged. These standards are due to the European Commission by January 2025.

3.2.2 Australia

Australia has a mandatory close-out requirement that is found in the rules of the Australian Securities Exchange (**ASX**). The ASX operates both the equities trading exchange as well as a clearing and settlement facility. Settlement in Australia is currently T+2. Similar to the CNS settlement process in Canada, Australia relies on the batch settlement system, where trades are netted before being settled. Australian close-out requirements operate within such system.

The "Automatic Close Out" (**ACO**) provisions are found in Section 10 of the ASX Settlement Operating Rules[11] and Section 9 of the ASX Settlement Procedure Guidelines.[12] These provisions impose a requirement on the participant of the settlement facility (**Settlement Participant**).

For any transaction that has not settled on the 2nd business day after expected settlement (i.e., T+4), the Settlement Participant must either:

- Close out the settlement shortfall on the next business day (i.e., T+5) by purchasing the unsettled quantity of the shares; or
- Borrow the shares to cover the shortfall by no more than 2 business days later (i.e., T+6)

Essentially, the rules require a Settlement Participant to either buy back the shares by T+5 (for complete settlement by T+7) or borrow the shortfall by T+6.

ASX Guidance[13] suggests that unless a Settlement Participant has a high degree of confidence that it can borrow the shares by T+6 (or has other arrangements in place to ensure that the fail is entirely cured by T+8), it should be covering the fail on T+5.

If the Settlement Participant is also a market participant, it may cover the fail itself, otherwise it may instruct a market participant to cover on its behalf.

The ultimate goal of the ACO is to ensure that all failed trades have a finite date, and are eliminated by T+8.

Failure to comply with this rule empowers the ASX to take enforcement action against the Settlement Participant and also attracts the imposition of fail fees by the ASX for each day that the settlement obligation remains outstanding.

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11 ASX Settlement Section 10 - Batch Settlement

12 Settlement (asxonline.com)

13 Maintenance of an Orderly Market when Closing Out Settlement Failures

3.2.3 Conclusion

Given the variety of approaches to addressing settlement failures as set out above, introducing requirements to address persistent failures to settle would be consistent with other jurisdictions. We propose aligning our requirements with the U.S. approach given the interconnectedness of our markets and familiarity with U.S. requirements as compared to other jurisdictions.

4. Impacts of the Proposed Amendments

A detailed assessment of the impacts of the Proposed Amendments has been prepared and is included as Appendix 3.

CIRO acknowledges that the impacts of the Proposed Amendments on Investment Dealer Members and investors may be significant. We expect these impacts would include:

- Investment Dealer Members that sell listed securities may need to undertake significant developments to their systems and operations, and create policies and procedures to, among other things:
    - monitor and track fail-to-deliver positions
    - buy or borrow shares to close out by the specified timelines to bring the fail-to-deliver position to a net flat or net long position
    - prevent short selling without pre-borrowing where fail-to-deliver positions have not been closed out as required
    - require clients or traders to make pre-borrow arrangements where appropriate
- investors may be required to buy or borrow shares to close out a fail-to-deliver position within specified timelines, or to pre-borrow prior to short selling where there has been a failure to close out, which may in turn increase the transaction costs
- Investment Dealer Members that are not Participants would need to update their processes and policies and procedures to ensure they have a reasonable expectation to settle a short sale on settlement date prior to order entry.

We expect that there may be greater impacts to Investment Dealer Members and clients that sell listed securities that have traditionally experienced higher rates of settlement failure. When CIRO conducted the Failed Trade Study in 2022, we concluded that junior securities (as identified by their listing market) generally have more settlement issues than senior securities.[14] We also recognize that smaller or regional dealers may face greater challenges in terms of dedicating the resources necessary to implement mandatory close-out requirements and may also face restrictions in accessing securities where pre-borrowing may be required under the Proposed Amendments.

[14] IIROC Failed Trade Study

5. Implementation

If approved, the Proposed Amendments would become effective no sooner than 180 days after the publication of the Notice of Approval. We believe it is important to fully understand the implementation impact of the Proposed Amendments before finalizing an implementation period. Therefore, we are soliciting comments from stakeholders regarding implementation impacts, costs, appropriate timing and alternative approaches. These comments are important to developing a full understanding of the impacts, which will assist in finalizing the implementation timeline and process.

6. Questions

While comment is requested on all aspects of the Proposed Amendments, comment is also specifically requested on the following questions:

Question 1

To what extent do Investment Dealer Members currently use CDS Participants for clearing and settlement that are not Investment Dealer Members? It is important that we assess the risk of regulatory arbitrage, as the Proposed Amendments would become a CIRO requirement that would only affect Investment Dealer Members that are within CIRO's jurisdiction.

Would the Proposed Amendments create an incentive for Investment Dealer Members to seek entities that are not regulated by CIRO for clearing purposes, and/or create disadvantages for Investment Dealer Members that currently offer clearing and settlement?

Question 2

Do Clearing Members, or Investment Dealers that could be allocated a fail-to-deliver position from a Clearing Member, currently have the books and records in place to close out in a timely manner pursuant to the proposed timelines? This would require the tracking of a CNS fail-to-deliver position to one of the following in order to determine the applicable close-out timeline:

- Short sales or trades resulting from SME orders that do not relate to persons with Marketplace Trading Obligations when trading in securities for which that person has obligations: S+1
- Long sales: S+3
- Persons with Marketplace Trading Obligations when trading in a security for which that person has obligations: S+3
- Deemed to own: T+35

Question 3

We propose to allow Clearing Members to allocate all or a portion of the fail-to-deliver position to another Investment Dealer Member as long as that allocation is made in a reasonable and timely manner. Would the recent move to T+1 settlement affect the ability of Clearing Members to make allocations, or the ability of Allocated Members to close out under the specified timelines? Would Clearing Members have enough information from CDS or their own books and records to conduct allocations in a timely manner, and if not, what types of information would be required?

Question 4

Under the Proposed Amendments, we would expect the majority of trades in listed securities to be settled or closed out prior to ten days past settlement date, which is the current reporting timeline for extended failed trades. Given the proposed close-out requirements would apply to all sales, should we consider repealing or narrowing the reporting requirement for extended failed trades on Participants and Access Persons?

Question 5

Given that Investment Dealer Members may use different entities for clearing and trading purposes in Canada, would the proposed notification and reporting requirements ensure a consistent application of close-out and pre-borrow requirements similar to the regulatory framework under Regulation SHO? What are the operational or technical challenges associated with the proposed reporting or notification requirements?

Question 6

What are some relevant factors or considerations when ensuring purchases made on a marketplace to close out a fail-to-deliver position are being executed using reasonable commercial terms in a manner that is consistent with market integrity?

For example, should there be an exception to allow the purchase of securities made to close out fail-to-deliver positions to be executed off-marketplace in order to minimize potential market disruptions? Would the ability to conduct off-marketplace trades only benefit certain Investment Dealer Members that are able to find their own counterparties away from the marketplace? Would there be a greater benefit to the market to require these trades to occur on a marketplace for transparency purposes?

Question 7

To assist with our monitoring capabilities at CIRO, we are considering the use of a new marker for purchases executed on a marketplace for the purpose of closing out a fail to deliver position. While this marker would only be used for regulatory purposes and would not be publicly disseminated, we would like to seek feedback on whether there are any operational challenges faced by executing Participants in terms of implementing such a marker.

Question 8

Are there any common practices that are currently in place that may raise issues in complying with closing out under the specific timeframes or with the pre-borrow requirements as set out in the Proposed Amendments?

8a) Would the use of average price or accumulation accounts affect the ability of Investment Dealer Members to close out in a timely manner as required by the Proposed Amendments, and if so, how?

8b) Would the use of the SME marker for trades that are not executed by a person with Marketplace Trading Obligations in respect of their security of responsibility affect the ability of Participants to close out in a timely manner or pre-borrow as required by the Proposed Amendments, and if so, how?

Question 9

To facilitate the operation of a close-out framework in Canada, we are proposing reporting and notification requirements as set out above. We are requesting comment on whether Investment Dealer Members anticipate any challenges with the proposed reporting and notification requirements, and if so, please specify.

Question 10

Is the extended close-out timeline of T+35 calendar days appropriate for deemed to own securities, or should we consider a shortened close-out timeline for these transactions?

Question 11

Are there other situations that would warrant an extended close-out timeline, and if so, what other exceptions should we consider?

Question 12

SEC Rule 204 in Regulation SHO allows broker dealers that have not closed out fail-to-deliver positions to continue short selling as long as they pre-borrow for themselves or their clients in the affected security. Would this outcome be appropriate for Canada, or should we consider restricting short selling altogether where there is a failure to deliver?

Question 13

Given that we are proposing extending the requirement for a reasonable expectation to settle to Investment Dealer Members that are not Participants, should we also consolidate this requirement in the IDPC Rules, rather than having separate requirements in both UMIR and IDPC Rules?

Question 14

Have we identified all the proposed provisions that will materially impact clients, investors Investment Dealer Members, marketplaces or CIRO in our Impact Assessment? If not, please list any other proposed provisions that you believe will materially impact one or more parties and why.

Question 15

Overall, do you agree with CIRO's qualitative assessment of the benefits and impacts of the Proposed Amendments? Please provide reasons for your stance.

Question 16

We are proposing an implementation period of no less than six months after the publication of the final amendments, and request feedback on what implementation period would be appropriate to provide applicable Investment Dealer Members with sufficient time to make the changes necessary to comply with the Proposed Amendments.

7. Policy Development Process

7.1 Regulatory Purpose

The Proposed Amendments would:

- foster fair and efficient capital markets and promote market integrity,
- prevent fraudulent and manipulative acts and practices,
- promote just and equitable principles of trade and the duty to act fairly, honestly and in good faith,
- foster public confidence in capital markets, and
- provide effective market surveillance.

The Proposed Amendments do not involve a Rule that CIRO, its Members or Approved Persons must comply with in order to be exempted from a requirement of securities legislation.

7.2 Regulatory Process

The Board has determined the Proposed Amendments to be in the public interest and on November 20, 2024 approved them for public comment.

We consulted with the following CIRO advisory committees on this matter:

- CCLS Institutional Subcommittee
- CCLS Retail Subcommittee
- Investor Advisory Panel
- Market Rules Advisory Committee
- National Council

We also consulted with several individual Investment Dealer Members that currently trade securities that are inter-listed in the U.S. and/or have U.S.-based affiliates that trade listed securities.

After considering the comments on the Proposed Amendments received in response to this Request for Comments together with any comments of the CSA, CIRO staff may recommend revisions to the Proposed Amendments. If the revisions and comments received are not material

in nature, the Board has authorized the President to approve the revisions on CIRO's behalf and the revised Proposed Amendments will be subject to approval by the CSA. If the revisions or comments are material, CIRO staff will submit the Proposed Amendments, including any revisions, to the Board for approval for republication or implementation, as applicable.

8. Appendices

Appendix 1 - Proposed Amendments to UMIR / IDPC Rules (blacklined)

Appendix 2 - Proposed Amendments to UMIR / IDPC Rules (clean)

Appendix 3 - Impact Assessment