



INVESTMENT INDUSTRY ASSOCIATION OF CANADA
ASSOCIATION CANADIENNE DU COMMERCE DES VALEURS MOBILIÈRES

**RS Request for Comments
MIN 2007- 017
Provisions Respecting Short Sales and Failed Trades**

Summary

RS published a request for comments re: short sales and failed trades on September 7, 2007 (the Notice). Comments are due October 9, 2007.

The Notice outlines proposed amendments to the UMIR that deal with short sales and failed trades. In particular, the amendments would:

1. **repeal all restrictions on the price at which a short sale may be made.** This is consistent with action taken by the SEC to repeal price restrictions on short sales in the US. The requirement to mark an order as “short” remains to allow RS monitoring and intervention in situations it deems manipulative, deceptive or improper.

The amendments also allow RS to designate a particular security or class of securities as ineligible to be sold short. This provides flexibility to RS to respond to trading issues in particular securities.

2. **eliminate the requirement to file “Short Position Reports” if adequate information on short sales executed on a marketplace becomes available.** This reporting requirement was deemed to be an administrative burden without a commensurate regulatory purpose. The repeal of this requirement would only become effective if adequate information on short sales executed on a marketplace had become generally available. To replace the report, RS envisages the dissemination by third parties of periodic summary reports of short sales effected on marketplaces in particular securities. In the view of RS staff, the summary report of short sales should be produced at least twice per month, and that the release of the summary report should be delayed for three trading days to allow for time to correct the markers on any order on a post-trade basis.

3. **require that notice must be provided to a Market Regulator if, after the execution of a trade, the trade is varied (with respect to price, volume or settlement date) or cancelled.** If the cancellation or variation is not made in accordance with UMIR or with such notice, the trade cannot be varied or cancelled. The purpose of the provision is to ensure that a trade variation or cancellation is not effected outside the normal processes of the marketplaces and CDS unless RS is notified and has had the opportunity to review the changes for possible market integrity concerns.
4. **provide a definition of a “failed trade” and require that the Participant or Access Person provide a report of a “failed trade” be made to a Market Regulator if the reason for the failure is not resolved within ten trading days following the original settlement date of the trade.**

The amendments define a failed trade as a trade resulting from the execution of an order entered by a Participant or Access Person on a marketplace on behalf of an account and:

- in the case of a sale, other than a short sale, the account failed to make available securities in such number and form;
- in the case of a short sale, the account failed to make:
 - available securities in such number and form, or
 - arrangements with the Participant or Access Person to borrow securities in such number and form; and
- in the case of a purchase, the account failed to make available monies in such amount,

as to permit the settlement of the trade at the time on the date contemplated on the execution of the trade. The definition also confirms that a trade shall be considered a “failed trade” irrespective of whether the trade has been settled in accordance with the rules or requirements of the clearing agency. The definition measures the existence of a “failed trade” at the account level and the default of the account holder in meeting settlement obligations. For example, if a Participant “fails” to settle both the purchase and sale of given amount of a particular security, the position of the Participant at the clearing agency may be “accurate” as a result of continuous net settlement but there remain two accounts which have defaulted on their settlement obligations. If this default persisted for a period of ten trading days beyond the normal settlement date, each of the accounts would be considered to have a “failed trade”.

The report of a failed trade is not currently required, but is proposed in order to ensure that the audit trail for any trade is accurate and that RS has sufficient information to evaluate whether trading activity has been conducted in compliance with regulatory requirements. Once the initial

report of a failed trade (to be filed on the eleventh day following the original settlement day) has been filed, a second report is required once the account had cured the default (one day following the cure). This will assist RS in monitoring trends and determining whether a security should be designated as a Short Sale Ineligible Security.

5. **provide that a Market Integrity Official may cancel a “failed trade” under certain circumstances.** Specifically, if in the opinion of a Market Integrity Official:

- the account has failed to diligently pursue making available the applicable securities or monies or making arrangements for the borrowing of the applicable securities;
- there is no reasonable prospect that the failure will be rectified pursuant to the rules, requirements or procedures of the marketplace on which the trade was executed or the clearing agency through which the trade was to be settled; and
- the cancellation of the trade is appropriate in the interest of a fair and orderly market.

This is targeted at the 2% of failed trades that are not resolved within 15 days after the expected settlement date.

6. **delete provisions for the “short exempt” order marker.** If the repeal of price restrictions on a short sale is approved, a consequential change to the order marking requirements is needed. The requirement for a special marker on short sale orders that are exempt from short sale price requirements will be deleted, but a requirement that a short sale be marked will be retained.

7. **clarify certain requirements that must be met for a seller to be considered the owner of securities at the time of a sale.** The amendments specify that in order to be deemed to have converted, exchanged or exercised securities, the seller must have taken all steps necessary to be legally entitled to the security including having:

- made any payment required;
- submitted to the appropriate person any required forms or notices; and
- submitted if applicable, to the appropriate person any certificates for securities to be converted, exchanged or exercised.

If the seller has not taken all the steps to be legally entitled to the security, the seller will be considered to be making a short sale.