



**Appendix “C”**  
**Reconciliation of UMIR and Proposed Amendments to**  
**the IOSCO Recommendations on Regulation of Short Sales**

IOSCO Principle/Report Section	Specific Recommendations	Description of UMIR Provisions	
		Existing Provisions	Additional Commentary and Suggested Proposals
<b>Definition</b>	<b><i>The Report recognizes that not all jurisdictions consider the same activities to be “short selling”. The Report considers “short selling” to be the sale of stock that the seller does not own at the point of sale. The provisions under UMIR differ in the following areas:</i></b>	The UMIR provisions contain a more expansive definition of “short sale” than most jurisdictions, including the United States. As a result, the number of short sales will be higher in Canada than would be the case if the definition in the United States applied. In Canada, this means the person making the sale generally must have a “reasonable expectation” of settlement at the time of the sale. In the United States, the sales are treated as “long” even in circumstances when a failure of settlement is contemplated at the time of the sale.	
	Ownership of securities subject to a resale restriction imposed by securities legislation or a marketplace	Sale of any security subject to a resale restriction is a short sale and the seller must have a “reasonable expectation” of being able to settle at time of the sale.	In the US, the sale of certain “restricted” securities is considered a sale from a long position. Even under Rule 204 of Regulation SHO, a dealer is given an additional 36 days following failure to close out the position arising from the sale of certain “restricted” securities.
	Interpretation of “exercise” of option, right or warrant	The holder of an option, right or warrant must have taken all steps to “exercise” the option, right or warrant including the payment of money before the person is considered “long”. Similar provisions apply when a person is to acquire securities as a result of “tendering” or “converting”.	In the United States, the practice is that securities which are the subject of an option can be sold in the market from a “long” position and the proceeds of sale used to pay for the securities.
	Securities “unavailable” until after settlement date	If securities would, in the ordinary course, not be available until after the scheduled settlement date, the trade is a short sale and the seller must have a “reasonable expectation” of being able to settle at the time of the sale.	The additional restrictions in Canada that apply before a person is considered “long” increase the proportion of short sales and require the Participant to take steps to have a “reasonable expectation” of being in a position to settle. Even under Rule 204, a dealer in the US is given an additional 3 days following failure to close out the position arising from the sale of “unavailable” securities.
<b>Principle 1</b>	<b><i>Short selling activities should be subject to appropriate controls to reduce or minimise the potential risks that could affect the orderly and efficient functioning and stability of financial markets.</i></b>		



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3.7	“Effective discipline for settlement of short selling transactions is the first pillar for an effective short selling regime.	If a short sale is made without a “reasonable expectation” of settlement, UMIR provides that the trade constitutes manipulative and deceptive activity contrary to Rule 2.2 of UMIR.	Studies by IIROC found that, in Canada, a short sale was significantly less likely to fail than trades from long positions, generally. In part, this result is due to the fact that short selling is concentrated in those classes of securities with the lowest trade failure rates (senior listed equity securities). Historically, failure rates in Canada have been less than those in the United States. The implementation of Rule 204 significantly reduced US trade failure rates to the extent that US rates may now be less than the prevailing failure rates in Canada. However, studies by IIROC found that failure rates varied significantly amongst securities. “Junior” securities were, for instance, found to have the highest rates. Increases in the proportion of trading accounted for by junior securities since early 2009 have resulted in slightly higher overall failure rates in Canada, without changing the underlying patterns.
3.13	In some jurisdictions, settlement of failed trades achieved by compulsory buy-in or close-out provisions. In some markets, the process is initiated by either the securities settlement system or the buyer who has not received the securities. Some markets impose a monetary penalty.	CDS has “buy-in” provisions which, if initiated by the purchaser who has failed to receive, are mandatory on the defaulting dealer.	As indicated in the studies undertaken by IIROC, the number of trades executed on marketplaces has increased dramatically over the three-year period - May of 2007 to April 2010 - from approximately 10,000,000 trades per month to almost 30,000,000 trades while the number of initial buy-in notices received by CDS in connection with trade failures has remained relatively constant in the range of 30,000 to 40,000 notices per month. Studies by IIROC also indicated that the majority of trade failures arose out of “administrative error” and were readily resolved. For this reason, a “hard” close-out requirement has the effect of transferring the cost to dealers that have failed to settle for “innocent” reasons.  One proposal considered by IIROC was the introduction of a “capital charge” on the dealer that failed to receive the security which would act as an incentive for that dealer to exercise its buy-in rights. Another option considered was the introduction of an administrative penalty to be imposed on the dealer that failed to deliver. Neither option was pursued given the reasons for settlement failure and the rates of failure. IIROC was of the opinion that, if the underlying patterns for trade failure in Canada showed signs of increasing, a simplified “penalty” would be the preferred option but that consideration might also be given to a “capital charge” on one or both sides of the failed trade.



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3.14	Encourages the adoption of T+3 as the standard settlement cycle.	T+3 is the standard settlement cycle provided for under UMIR.	Studies by IIROC have indicated that trades which are subject to “special terms”, including those related to settlement, have a higher likelihood of settlement failure than “ordinary” trades.
3.16	To support “strict settlement”, regulators could adopt eligibility criteria for stocks eligible for short selling, pre-borrowing or ‘locate’ requirements, price restrictions or “flagging” as appropriate for individual markets.	Under UMIR, all short sales must be “marked” (either as a “short sale subject to price restrictions or as “short exempt”). UMIR presently provides that a security may be designated as a “Short Sale Ineligible Security” (which precludes any short sale of the particular security subject to certain enumerated exceptions). Unless designated as a “Short Sale Ineligible Security”, the security may be sold short.	Given the historic rates of trade failure, studies by IIROC supported the conclusion that general requirements related to “pre-borrowing” or “locate” of securities were not warranted in the Canadian setting. Under the Proposed Amendments, IIROC is proposing to require a pre-borrowing requirement for short sales but its application would be restricted to persons who had executed an “extended failed trade” in any security (i.e. a fail that has persisted for 10 days following the intended settlement date) or in respect of securities with increases in rates of trade failure and short sale activity.  While IIROC is proposing to proceed with the repeal of price restrictions on short sales, IIROC is proposing that the existing “short exempt” marker be used to identify the purchase or sale of a security by an account that is active in the security but essentially, in the ordinary course, aims to be “flat” holdings of a particular security at the end of each trading day (such as arbitrage account, market makers, odd lot dealers and high frequency traders). This would simplify the marking of orders for certain accounts and remove the “chaff” from IIROC’s monitoring of short sale activity. (IIROC would also be in a position to monitor the relative buying and selling activity of “short-marking exempt” accounts in a particular security throughout a trading day.)
<b>Principle 2</b>	<b><i>Short selling should be subject to a reporting regime that provides timely information to the market or to market authorities.</i></b>		
3.17	To achieve “enhanced and meaningful” reporting, should consider reporting short selling information to the market (or at a minimum, to market authorities).	UMIR currently requires the marking of all short sales and this marker is displayed to IIROC but not included in the public display.	IIROC has been pursuing the introduction of trading summaries of short sales for particular securities (aggregated by trading activity across all marketplaces trading the security). One of the objectives of providing this information is to demonstrate to the investing public that there are established patterns for different classes of securities (e.g. those included in an “investable” index, underlying interests of a listed option, inter-listed with markets outside of Canada). These patterns reflect hedging, arbitrage and market making activities, together with



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			the liquidity profile of the particular security. IIROC hopes to be in a position by the implementation date of the Proposed Amendments, to publicly provide such reports on a semi-monthly basis. IIROC continues to encourage the marketplaces to publicly provide information on a more frequent basis and ideally in a consolidated report.
3.19	Recognize that information on short selling may mislead the market and expose the seller to a “short squeeze”.	Attempting to “corner” the market to affect a short squeeze is presently recognized as a manipulative and deceptive activity that is prohibited under UMIR.	IIROC believes that the important element in short sale data is the underlying pattern or trend. Daily information for a particular security can be distorted by the effects of a small number of trades, particularly with securities of limited liquidity or high volatility. IIROC continues to believe that the “short sale” and “short-marking exempt” flags should not be included in the public order display but must continue to be available to IIROC in real-time.
3.22	Reporting system could be based on “flagging” or “short position” or a comprehensive regime could adopt both models	IIROC continues to pursue the introduction of trading summaries based on “marked” short sales. UMIR requires that Participants and Access Persons file short position reports on a bi-monthly basis.	In 2007, IIROC had proposed to repeal the requirement for short position reports to be effective following the introduction of an “adequate replacement” (such as the short sale trading summary reports). IIROC is withdrawing the proposed repeal. While the Consolidated Short Position Report is “flawed”, relatively costly and cumbersome to compile, IIROC recognizes that the reports are a source of information with an established history. For this reason, the proposed trading summaries of “short sales” for each listed security would be provided semi-monthly to correspond with the reporting period for the Consolidated Short Position Report.
3.23.1	Reporting which excludes derivatives may not provide full picture and “induce a migration of trading activities to the derivatives market”.	UMIR does not require information on derivative positions to be included in the short position report.	Information on the outstanding interest in listed derivatives is already publicly available. IIROC acknowledges that there is no source of information on positions subject to over-the-counter derivatives.
3.23.2	Including derivatives would increase complexity and have practical issues associated with collection of derivative data. Recommends assessment of the balance of difficulties and benefits.	UMIR presently exempts from execution on a marketplace transactions related to the exercise of an option or other derivative transaction.	The OSC/CSA have considered proposals to replace the Canadian Unlisted Board with a more comprehensive national trade reporting regime. IIROC has indicated that such an initiative, if IIROC were to act as administrator, could be dovetailed with a more comprehensive reporting of trades of listed securities which have been executed off-marketplace (including on the exercise of OTC derivatives or execution outside of Canada that has not been reported in that foreign jurisdiction). IIROC does not expect that this initiative will be actively pursued in the foreseeable future.



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3.23.3	Recommends consideration of objective and usage of data collected in determining whether reporting of short position on gross or net basis is more appropriate.	UMIR requires the reporting of short positions on a gross basis.	
3.23.5	Trigger level for reporting and frequency of reporting must balance costs of compliance with provision of useful information to “reduce the risk of manipulative and other unfair trading practices”.	UMIR does not require “holder” level reporting. When appropriate, this information is obtained from the dealer providing the short position report.	The Consolidated Short Position Report has not proven to be a useful tool for monitoring or investigative purposes. Introducing additional account level requirements would not provide information that was more timely or meaningful than the enhancement of the information available through the monitoring of “marked” trades both in real-time time and on post-trade analysis. IIROC has had outstanding, since April of 2007, a proposal that would require the unique identifier of each Direct Market Access (“DMA”) client to be included with each order, including short sales. This proposal would formalize the practice adopted by marketplaces that require the DMA account identified on the order. The inclusion of DMA account information allows real-time monitoring of account level activity of institutional accounts for all requirements and not just short sales. There is also a comprehensive database for post-trade analysis. In the view of IIROC, the monitoring of short sales should be integrated into surveillance systems which already monitor for anomalous price or volume movements in a particular security in real-time. In particular, IIROC is developing an alert which will consider increases in the rate of short selling in conjunction with declines in market price. The alert will help identify in real-time situations that may require further regulatory action (including possible designation of the security as “Pre-Borrow Security” or “Short Sale Ineligible Security”).
3.23.6	Triggers and threshold levels may need to be fine-tuned as more experience is gained.	N/A	The thresholds and triggers proposed or adopted in other jurisdictions do not reflect the divergent patterns of short selling/short positions between marketplaces and classes of securities. For example, the most common proposed threshold is if the short position of a person exceeds 0.25% of issued share capital of the issuer. By comparison, in March of 2009, the average short position in a security listed on the TSX Venture Exchange was 0.010% of issued capital.



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3.23.7	Reporting should be done as soon as practicable.	N/A	Studies by IIROC indicated that short selling is not a significant contributing factor in the decline of prices in the Canadian market, even during periods of rapid price decline, such as during the second half of 2008. In fact, short selling and short positions declined dramatically during this period particularly in respect of the “junior” securities which were perceived to be the most vulnerable to short selling abuse.
3.23.8	Reporting should be by the “holder” of the short position (as brokers may not have complete information) but recognize that authorities may not have jurisdiction over the “ultimate” holder.	N/A	The jurisdiction of IIROC is limited to Participants and Access Person and does not extend to investors. However, IIROC continues to believe that the most effective tool to avoid abusive short selling is to monitor trading activity in real-time, so that abusive activity can be detected quickly and regulatory action taken, when appropriate, in a timely manner.
3.25	As brokers are responsible for “flagging”, may be easier to monitor compliance with flagging of short sales as compared to short position reporting.	Trade Desk reviews and audits of Participants monitor “marking” and “short position reporting” compliance.	“Holder” level reporting is really only relevant if the shorting activity is of a nature or extent that it is impacting market prices. If such an impact is observed, account level information can be requested from the Participant.
3.26	Flagging may not help in assessing outstanding short positions or large individual positions.	N/A. UMIR currently requires each dealer to prepare a short position report which is aggregated with other reports in the Consolidated Short Position Report.	IIROC’s ability to identify institutional DMA clients on orders is an important factor in creating real-time monitoring and the ability to determine trading patterns. IIROC is proposing to withdraw their proposal to repeal the short position report. As such, IIROC will be able to monitor changes in the short positions of individual securities and to then supplement that data with information from the trading summaries.
<b>Principle 3</b>	<b><i>Short selling should be subject to an effective compliance and enforcement system.</i></b>		



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3.28	View that instituting a strict settlement of failed trades “is one of the pillars of a short selling regulatory regime”. Regular monitoring and inspections of settlement failures is important, especially for those firms which frequently fail to deliver.	<p>UMIR makes Participant responsible for settlement of each trade and provides that they must have a “reasonable expectation” of settlement at the time of order entry.</p> <p>UMIR will require Participants to report with respect to positions that have not been rectified within 10 days of the intended settlement date.</p>	IIROC monitors trade failure rates generally, based on information provided by CDS. CDS and the OSC are developing a database of daily initial trade failure reports involving the continuous net settlement facilities of CDS. Access to this database would permit IIROC to determine, from time to time, patterns of failure among Participants and securities. IIROC will also be able to establish patterns with respect to “extended failed trades” based on reports filed with IIROC regarding these positions and their resolution. IIROC has set June 1, 2011 as the implementation date of the “extended failed trade reporting” system (other than for trades using the “Trade for Trade” settlement system at CDS which will be implemented at a later date).
3.30	Where there is a “flagging” regime appropriate parties should be required to maintain books and records of short sales for a sufficient period of time.	UMIR requires that order information be retained for a period of seven years and during the first two years the retention must be in a “readily accessible location”.	The UMIR requirements complement National Instrument 23-101 requirements which deal with the maintenance of order and trade information not otherwise covered by UMIR (e.g. orders and trades involving derivatives).
3.31	Encourages establishment of a mechanism to analyse the information obtained from flagging or short position reporting to identify potential market abuses and systemic risk.		<p>Historically, IIROC has analysed the data with respect to short sales to establish trends and patterns and has periodically provided the results of this analysis to the securities regulatory authorities and published relevant portions of the data in reports.</p> <p>IIROC will be introducing a new alert to monitor for a combination of price movement and changes in patterns of short selling. A Surveillance Officer will then be able to determine, in real-time, if abusive short selling is contributing to a significant price decline for a particular security.</p> <p>IIROC has an “unreasonable” price policy under which IIROC may undertake a “regulatory intervention” if there is unreasonable trading or trading which is not in compliance with UMIR. IIROC is proposing to make the policy for regulatory intervention more publicly transparent through the issuance of guidance. The regulatory intervention policy is both general and comprehensive and is triggered by any “unexplained” price movement and not just price declines resulting from short selling activity.</p>
<b>Principle 4</b>	<b><i>Short selling regulation should allow appropriate exceptions for certain types of transactions for efficient market functioning and development.</i></b>		



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3.37	Short selling regulation regime should “not stifle legitimate short selling activities”.		Based on the studies and monitoring undertaken by IIROC, it would appear that the perceived abuses that manifested themselves in other jurisdictions were not evident in the Canadian market. IIROC is therefore reluctant to propose additional administrative and regulatory burdens to address problems which do not presently exist. IIROC recognizes that it must continue to monitor trading activity and be in a position to respond (either on its own or in combination with the CSA, CDS and/or marketplaces) should such problems develop in the Canadian context.
3.38	Should be appropriate exceptions for hedging, market making and arbitrage. Suggest consideration of whether failed trades arising from market making activities should be allowed more time to settle or be exempt from price restrictions.	UMIR provides exceptions from price restrictions on short sales for hedging, market making and arbitrage. Additional exceptions are provided for various specialty type orders, Exchange-traded Funds and to satisfy displacement obligations imposed under the “best price” rules of UMIR. Comparable exceptions (other than for specialty orders) apply to the ability to make a short sale of a Short Sale Ineligible Security.	
3.39	While exempted activities may need to be covered by reporting to regulators consideration should be given to exemptions from “public disclosure” to protect interests of parties engaged in the activity.	Under UMIR, the short sale “markings” are not to be included in the public display. However, all “markings” are visible to IIROC for its monitoring activities.	Under the Proposed Amendments, IIROC is proposing a separate “flagging” marker for the purchase or sale by an account that in the ordinary course does not “carry a position” (such as market makers, arbitrageurs and certain institutional accounts that adopt a “directionally neutral” strategy in the trading of securities). This separate category will allow IIROC to monitor the trading activities of this group of persons separate from traditional short selling activity. This separate marking for “short-marking exempt orders” would not be available to the public.
3.40	Exemptions should be clearly defined (particularly in respect of “market making” and “hedging” activities).	UMIR defines “Market Maker Obligations” by reference to Exchange rules. UMIR does not provide exceptions for “informal” market makers. Hedging activities are limited to recognized “derivatives market maker” and “Program Trades” as defined by Exchange rules.	IIROC is presently proposing to replace the definition of “Market Maker Obligations” with a new defined term “Marketplace Trading Obligations” which has been expanded to take into account odd lot and other trading obligations imposed pursuant to a contact between marketplaces and their members or users.