

Goodmans^{LLP} Update

IIROC Issues Guidance on Short Sale Orders and the Reasonable Expectation to Settle Resulting Trades

On August 17, 2022, the Investment Industry Regulatory Organization of Canada (IIROC) issued Notice 22-0130 *Guidance on Participant Obligations to have Reasonable Expectation to Settle any Trade Resulting from the Entry of a Short Sale Order* (“**Notice**”).

The Notice provides guidance on the obligations of market participants engaged in short selling and confirms that the Universal Market Integrity Rules (UMIR) prohibit any entry of a short sale order by a participant without a reasonable expectation that they will acquire the securities necessary to settle resulting trades on the settlement date. Specifically, IIROC expects participants to have “reasonable certainty” prior to the entry of the short sale order that they can acquire sufficient securities by the settlement date, which is generally two days following the trade date.

Short Sale Defined

IIROC defines a short sale as the sale of a security, other than a derivative instrument, which the seller does not own either directly or through an agent or trustee. The Notice clarifies that, among other things, a seller is not considered to own a security where:

- the security held by the seller is subject to any restrictions on sale imposed by applicable securities legislation or by an exchange as a condition of the listing of the security; or
- the settlement date or issuance date pursuant to an unconditional contract to purchase, a tender of a security for conversion or exchange, an exercise of an option, or an exercise of a right or warrant, would, in the ordinary course, be after the date for settlement of the sale.

Preventing Manipulative and Deceptive Activities

The Notice targets what is commonly referred to as “naked short selling”, a practice whereby a seller enters into a short sale order without having made formal arrangements to borrow or acquire the shorted securities by the settlement date. Entering into such an order without having a reasonable expectation of settling the resulting trades falls within the list of activities in Part 2 of Policy 2.2 that may constitute a violation of UMIR 2.2 – Manipulative and Deceptive Activities.

The Notice confirms that a participant is prohibited from entering into a short sale order if they know or ought reasonably to know that it is unlikely that sufficient securities will be available and accessible to deliver on the settlement date. Among other things, this means that a participant may not be able to demonstrate a reasonable expectation to settle in the following circumstances:

- the securities being sold short are difficult to borrow;

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- the person on behalf of whom the short sale order is entered previously executed trades where shares were not available to deliver on the settlement date; or
- the client expects to receive securities after the settlement date of the short sale order.

The Notice provides additional clarity on the last point. If the securities being sold short are subject to statutory resale restrictions expiring after the settlement date, or are subject to a financing that will not close by the settlement date, the participant cannot rely on these securities to establish a “reasonable expectation” to settle. In both circumstances, the shorted securities would not be available to deliver on the settlement date of the short sale trade, thereby contravening UMIR 2.2.

For assistance analyzing the application of the Notice to your business, or for assistance approaching IIROC regarding your business practices, please contact any member of our [Financial Services Regulatory Group](#).

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