Save Canadian Mining

Response to: CSA Consultation Paper 25-403 Activist Short Selling

March 3, 2021

ADDRESSED TO:

- British Columbia Securities Commission
- Alberta Securities Commission
- Financial and Consumer Affairs Authority of Saskatchewan
- 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
- Superintendent of Securities, Yukon Territory
- Superintendent of Securities, Northwest Territories
- Superintendent of Securities, Nunavut

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SECTION 1: INTRODUCTION AND OVERVIEW

Save Canadian Mining (SCM) is pleased to submit these comments to the CSA *Consultation Paper 25-403 Activist Short Selling* for review.

Since 2019, SCM has been the voice of Canada's junior mining sector, and has been advocating in Ontario for greater regulatory oversight of activist and predatory short selling practices. SCM was launched in response to widespread perceptions within the industry that there are fundamental structural problems within Canada's capital markets that are enabling activist and predatory short selling while preventing junior mining companies from being able to raise capital and compete in Canada's commodity driven economy.

SCM was launched with the support of its founding members, including: the Ontario Mining Association (OMA); the Ontario Prospectors Association (OPA); the TSX Venture Exchange; as well as notable industry investors like Eric Sprott (Sprott Mining Inc.); and Rob McEwen (McEwen Mining Inc.). In addition, SCM is supported by a notable junior mining companies First Majestic Silver Corp., and Osisko Mining Inc. Many junior mining companies, investors and impacted stakeholders have lent their support to this effort and SCM has collected the "signatures" of over 3,000 people since its inception. These founding partners and supporters lent quotes to SCM's news release commemorating the campaign's launch.[1]

Most recently, SCM has been working with the Ontario government, Ontario's Capital Markets Modernization Taskforce (CMM Taskforce), the Ontario Securities Commission (OSC) and IIROC to make known the perception in Canada's junior mining sector that activist and predatory short selling is a pervasive problem that needs to be addressed through greater regulatory controls.

SCM's specific recommendations have been consistent throughout the campaign's evolution. SCM is pleased to offer these as part of the CSA consultation on predatory and activist short selling for consideration. These include that capital market regulators need to urgently address:

1. "Naked short selling" by ensuring that stock is available before it is borrowed in the short selling context, and that settlements would have a better than reasonable chance of being realized; and
2. "Tick test" re-instatement that would revive the 147-year-old regulation that was repealed in 2012 by IIROC and which would help reverse the downward trend of valuations in the highly non-liquid securities segment of tradable stocks.

These requests are based on initial industry assumptions, and have since backed up with research conducted by both SCM and data shared with SCM by IIROC. Reference material from SCM's proprietary research is included in this submission.

In terms of its ongoing work in Ontario, SCM has had the privilege of being the leading voice of Canada's junior mining industry in the public review of Ontario's Securities Act which commenced in December

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[1] Save Canadian Mining News release: "Junior Mining Sector Responds to Predatory Short Selling; Launches Save Canadian Mining." Newsfile Corp. November 19, 2019, (https://www.newsfilecorp.com/release/49806/Junior-Mining-Sector-Responds-to-Predatory-Short-Selling-Launches-Save-Canadian-Mining)

2019, and concluded in December 2020. The CMM Taskforce was appointed by the Ontario Minister of Finance in December 2019 to "*review and modernize the province's capital markets regulations*."[2] Over the course of 2020, SCM has met with the taskforce twice, and was able to make two separate submissions. The taskforce issued their final report to the Ontario Minister of Finance in December 2020, which was made public in January 2021. The final report included one specific recommendation that SCM was proud to help influence, and which we publicly supported upon the report's publication.[3] Specifically, recommendation #25, which addresses the problem of "naked short selling," and included the below language, is one that SCM continues to advocate for implementation of:

> ***Recommendation #25:***
>
> *"The Taskforce recommends that IIROC revise its UMIR to require an investment dealer to confirm the ability to borrow securities prior to accepting a short sale order from another person or entering an order for its own account."*
>
> *"Should a short sale fail to settle, the short seller would be subject to a mandatory buy-in. To allow for fails due to administrative issues, the buy-in requirement would be triggered at settlement date +2 (trading date +4). The obligation to execute the buy-in would rest with the dealer. This would accommodate administrative delays, such as legend removal or delayed corporate actions."*[4]

The final report did not, however, acknowledge one regulatory change that SCM has been campaigning on since its inception in November 2019 - that being the re-instatement of the tick test.

In conversation with IIROC, the reasons provided by the regulator for the repeal of the tick test in 2012 did not satisfy the thousands of junior issuers in the mining industry who have been struggling to raise the capital they require for years. In these conversations SCM was presented with arguments as to why the repeal took place. The one argument that with the advent of new smaller exchanges (of which there are now 14 in Canada) prevented the regulator from tracking the direction of each stock in real time on a "consolidated tape," has not satisfied our campaign. IIROC's next argument that the tick test never really had an impact on the ability of public companies to raise capital in a fair environment was also discredited through their own data that they made available to SCM following its meetings with them in the Summer of 2020.

In addition to this, and after reviewing the consultation that IIROC undertook in 2012 prior to making the decision to repeal the tick test, there is a clear lack of input from our stakeholder segment. In SCM's opinion, the consultation was incomplete without the critical voice of those who would be the most impacted (i.e., the junior issuers). The tick test should at least be reviewed again now that there is over 8

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[2] Ontario Government News Release: "Ontario Appoints Members of Taskforce to Review Capital Markets." February 6, 2020. (https://news.ontario.ca/en/release/55674/ontario-appoints-members-of-taskforce-to-review-capital-markets).

[3] Save Canadian Mining News Release: "Save Canadian Mining Congratulates the Capital Markets Modernization Taskforce on Addressing Predatory Short Selling in Final Report." Newsfile, January 25, 2021. (https://www.newsfilecorp.com/release/72710/Save-Canadian-Mining-Congratulates-Ontarios-Capital-Markets-Modernization-Taskforce-on-Addressing-Predatory-Short-Selling-in-Final-Report).

[4] "Capital Markets Modernization Taskforce: Final Report January 2021," https://www.ontario.ca/document/capital-markets-modernization-taskforce-final-report-january-2021/22-regulation-competitive-advantage

years of data on the impact that this decision has had. SCM feels that the discussion should be reintroduced for consultation, and that junior issuers should be invited to share their experiences and opinions on what has become a major regulatory loophole for predatory and activist short-sellers to exploit.

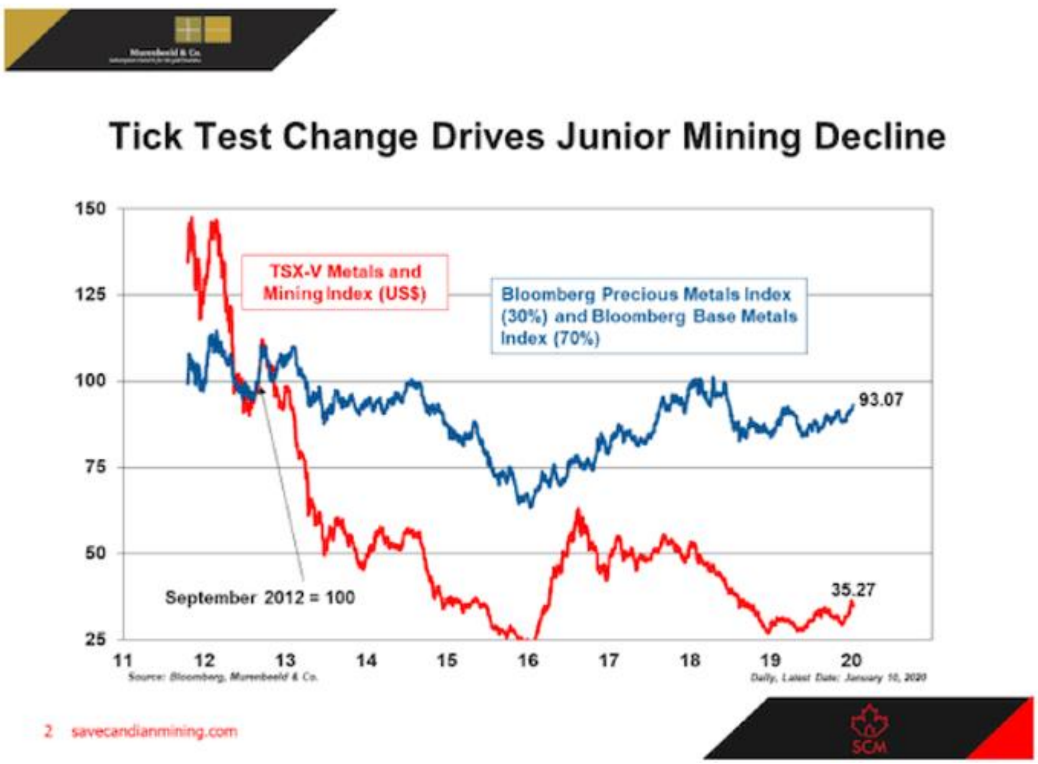
The following expands on SCM's argument on the tick test, and includes the research that backs up our claims.

SECTION 2: A Case for the Tick Test

SCM was founded with the specific goal to have regulators reinstate the following regulation that was repealed in 2012 by IIROC with the condition that it only be applied to junior mining stocks:

> *"Except as otherwise provided, a Participant or Access Person shall not make a short sale of a security on a marketplace unless the price is at or above the last sale price."* – IIROC Universal Market Integrity Rules: Rules & Policies.[5]

In the Spring of 2020, SCM released research that provided data that we felt proved there were structural problems in Canada's capital markets. The research included in the following chart demonstrates the divergence between commodity prices and the valuations of mining companies on the TSX Venture Exchange (TSX.V). We feel this data illustrates that a structural and/or regulatory problem clearly exists, and that regulators have an obligation to address it:



SCM's advocacy work has included two senior-level meetings with IIROC officials that were conducted in July and August 2020. While SCM greatly appreciated the opportunity to meet with IIROC and discuss the importance of the tick test in financial markets, SCM remains concerned that the tick test does not

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[5] IIROC's Universal Market Integrity Rules: Rules & Policies: (https://www.iiroc.ca/industry/rulebook/Documents/UMIR0301_en.pdf)

appear to be on their agenda for review. Specifically, SCM would like IIROC to develop a response to the following three statements:

1. Provide complete and adequate reasons for the repeal of the tick test in October 2012 to the satisfaction of SCM and the junior mining industry;
2. Acknowledge that there was (and still remains) a noticeable negative impact on non-highly liquid securities since the tick test was repealed; and
3. Acknowledge that junior issuers were not adequately consulted during the first public consultation on the removal of the tick test in 2012, and commit to re-opening the consultation.

The following sub-sections represent SCM's arguments on what we find to be compelling cause to reinstate the tick test. These arguments are based on research conducted following our initial submission to the Taskforce and are the direct result of the information exchanged between IIROC and SCM over the course of the summer 2020.

SECTION 2 (b) – *"Why was the Tick Test Repealed in the First Place?"*

Our first and primary concern reflects a curiosity as to the true motivations behind repealing the tick test in 2012. As many issuers understand it, the tick test was a regulation designed to protect vulnerable companies from being unfairly targeted by predatory short selling. It was a regulation that had been in place for 142 years prior to 2012. SCM has been unable to uncover any public arguments made by issuers for its repeal prior to 2012 and we are therefore left wondering about the chief motivating factors behind the decision.

In meetings with IIROC, and in publications by IIROC at the time of its decision to repeal the tick test, we understand the reasons that initiated the review to be the following:

- In IIROC's opinion and based on their own studies and data, "*the tick test (had) no appreciable impact on pricing*"[6];
- With the introduction of multiple exchanges, the tick test became a complicated regulation to administer given that a single stock could be traded across a number of different platforms; and
- The decision was made in full view of the public with little to no opposition at the time from major stakeholders.

SCM believes that the first assumption, i.e., that the tick test did not have a discernable impact on short selling, could not have been properly assessed given that it was a prohibited action to short a stock on a down tick prior to 2012. IIROC's own data shows that short selling accounted for approximately 20% of all trades both before and after 2012, with the action of selling on a down tick necessarily making up a portion of that activity following the repeal. The reason to repeal the tick test could not have been based on data evidence. We are also confused as to why the tick test would be repealed if its impact was even slightly beneficial to smaller, more vulnerable public issuers.

The second argument related to the inherent complications that the regulation would represent for the 14 different exchanges that securities are currently traded on, also confuses SCM and its partners. Primarily, SCM believes that 14 exchanges is too many for Canada's marketplace and that regulators

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[6] IIROC Rules Notice: *"Provisions Respecting the Regulation of Short Sales and Failed Trades."* March 2, 2012 (https://www.iiroc.ca/Documents/2012/7026f168-80c3-45ea-a635-55b8802dbbaf_en.pdf#search=short%20sale)

should restrict issuers to one exchange at any given time. Irrespective of this belief, SCM understands IIROC to be a highly sophisticated organization with the ability to see every trade made in Canada in real-time. IIROC has introduced new regulatory tools over the years that are highly automated and based on its technological capabilities. It remains difficult for SCM to believe that IIROC did not have the authority or technological capability to enforce the tick test even with the advent of multiple exchanges. In addition, the need for safeguards on vulnerable, non-highly liquid stocks on smaller exchanges and the TSX.V should have provided sufficient motivation to develop this capability if in fact the capability does not exist.

On the third argument, it is true that IIROC executed a fully transparent and public consultation in 2012 around the repeal of the tick test. SCM has reviewed the documents associated with this decision in detail. We have also reviewed the public submissions made to the consultation by the investment community. While we appreciate this decision was made in full view of the public, we nevertheless are concerned that: a) the reasoning provided in the March, 2, 2012 IIROC Notice for the interest in repealing the tick test (as outlined above); and b) the fact that there appears to be no consideration of the risks associated with the impact on smaller businesses / junior issuers.

SCM notes there were only 16 submissions made by stakeholders to the consultation paper issued by IIROC (or that were published and shared by IIROC). Of those 16 submissions, only two of them opposed the repeal of the tick test. These two submissions were made by individual, retail investors and neither submission articulates a comprehensive argument.[7] The remainder of the submissions appear to represent the views of larger investment organizations and exchanges. Interestingly, the TMX group made a submission in support of the repeal but has since joined SCM as a supporter of this campaign through the TSX.V.

Most alarmingly, there does not appear to be any input by the presumed most-impacted stakeholder base (smaller issuers). The fact these opinions are not included is in no fault of IIROC, but nevertheless leaves a significant gap in terms of the public debate on this topic. In SCM's opinion, there has yet to be a serious and comprehensive contemplation of the risks involved in this decision. SCM and its partners believe the junior mining community deserves to have a chance to weigh in and protect their industry.

SECTION 2 (c) – *IIROC Data Proves the Repeal of the Tick Test has Impacted Small Businesses / Issuers*

At SCM's request, IIROC compiled trade data that evaluated short selling activity prior to the repeal of the tick test and after. They were able to assess each short trade that occurred prior to the tick test being repealed. The following chart was provided by IIROC as part of our request for information:

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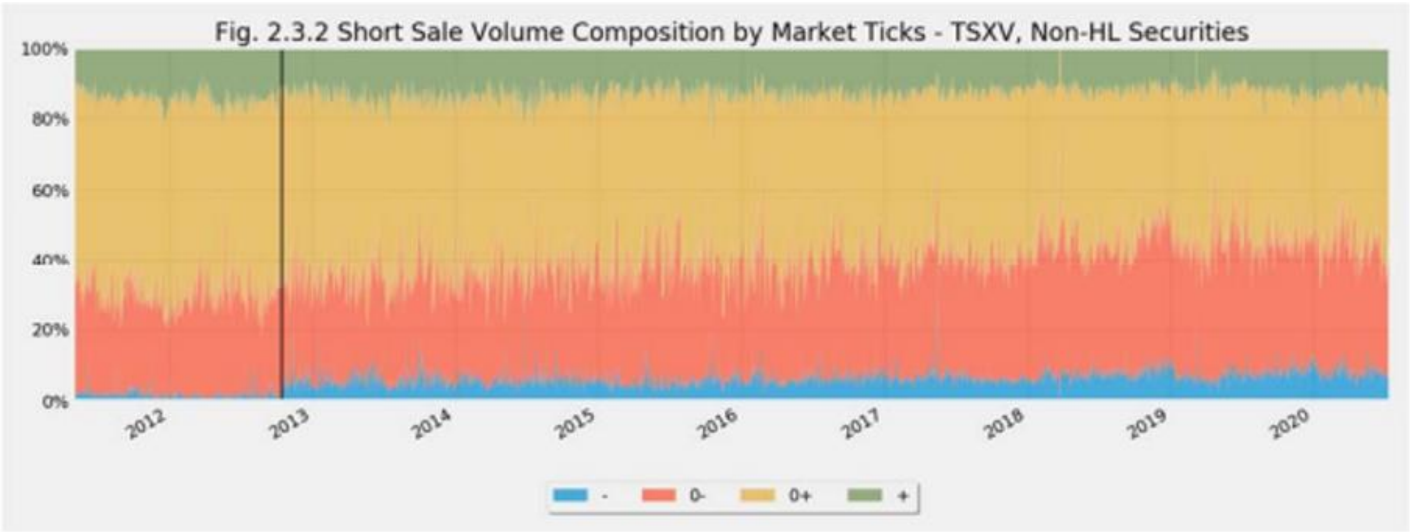
[7] IIROC Notice: "*Request for Comments, Provisions Respecting Regulation of Short Sales and Failed Trades*." February 245, 2011. https://www.iiroc.ca/SitePages/Related-Documents.aspx?linkid=752



The chart depicts all short sales on the TSX.V for non-highly liquid securities. SCM focussed on this chart given that the stakeholder group SCM represents (junior miners), would mostly fall into this data set. Selling on the down-tick is represented at the bottom of the chart in blue. As is evident, selling on the down-tick went from 0% of all short sales on the TSX.V in this category to between 5-12% following the repeal.

This data proves that what SCM has been claiming since its inception is true. IIROC's admission that selling on the down tick increased following the repeal of the tick test suggests there was in fact a value to a certain stakeholder group in having it present in the regulatory structure. In response to SCM's concern with this data, IIROC justified their decision to repeal the tick test with the following rationale:

A. While downward trajectory selling did increase on non-highly liquid securities on the TSX.V, it was marginal when benchmarked against overall short activity (which remains at around 20% of all trades). From an overall market perspective, the tick test had little to no impact;

B. Selling on the down tick was necessarily going to increase because prior to Oct 2012 it wasn't permitted;

C. The tick test represents "red tape" that should not be reinstated given the general objectives of the government and the Taskforce and lack of impact it had on the general market; and

D. There hasn't been enough data collected on the other smaller exchanges which almost exclusively house junior companies (e.g., the Canadian Securities Exchange, Neo, etc.) to make an informed conclusion, and more time is needed to study trades being conducted across the wider market.

In response to these positions, SCM would like to offer the following arguments:

a. While IIROC's data shows that selling on the down tick still represents a very small portion of the overall short selling activity on the TSX and the TSX.V, it does show that it nevertheless has gone up by a significant margin. When you consider that the largest increase in selling on a down tick occurred on the TSX.V for non-highly liquid securities, we feel it is likely those smaller issuers in the mining industry (and others) that have been most impacted;

b. Selling on the down tick was prohibited prior to 2012 and even though the percentage of these sales would necessarily increase following the regulation's repeal, the impact is nevertheless acute for those companies who have been made subject to predatory short selling through the removal of this restriction. Regulators should acknowledge that selling on the down-tick is a predatory form of short selling and properly identify the securities that were most impacted by this noticeable increase in short activity;

c. SCM and its members are very much in favour of reducing red-tape, particularly on smaller issuers. In certain circumstances, and particularly when addressing the needs of under-resourced small businesses, regulations are a necessary part of a healthy capital market framework. In the case of the tick test, we feel this is less about red tape and more about protecting a vulnerable industry; and

d. As part of its response to SCM's request for data related to non-highly liquid securities, IIROC presented research done on smaller exchanges such as NEO and the Canadian Securities Exchange (CSE). It was clear after reviewing these charts that while preliminary data does show an adverse consequence of the repeal, it would be fair to say that consistent patterns are not yet available due to the lack of trade volume on these exchanges. We would argue that the TSX.V data is sufficient, and that affected junior issuers should not have to wait for better data to revisit the importance of the tick test.

e. We believe the data IIROC has under reports the true problem. The current settlement process of T+2 +10 is in SCM opinion being abused by Predatory Short Sellers to disguise short selling activity. What happens we believe is on 11th day hedge fund flips trade to next numbered Company and starts the clock again. None of these trades are marketed short but before they become a failed trade it gets sold. The seller never borrows the stock and keeps on doing this putting increased pressure on Companies stock price and scaring real investors who think there is something they don't know about stock and they then become sellers. This enables stock prices to be suppressed and presents an easy profit opportunity for the Predatory Short Sellers. The dramatic difference in historical stock price action versus current is clearly demonstrated in the SCM research.

As highlighted in this document, there remains frustration and concern around the real motivation behind repealing the tick test in 2012, including that proper consultation with smaller issuers did not factor into the public discussion and the ultimate decision for its removal. In addition, IIROC's own data shows that the tick test did have a preventative function on predatory short selling, particularly on non-highly liquid securities on the TSX.V which is the category that captures the majority of SCM's supporters.

In the context of CSA's Consultation Paper 25-403 and the recent recommendations of the CMM Taskforce, we encourage further regulatory involvement to address activist and predatory short selling practices. Specifically, we encourage regulators to make a point of engaging junior issuers in upcoming decision making around this important issue within our capital markets. Regulatory support for junior issuers that would lead to greater controls over naked shorting and the reinstatement of the tick test, would go a long way to giving junior issuers and retail investors the confidence to continue to support the Canadian economy.

Yours truly,

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Terry Lynch
Executive Director
Save Canadian Mining Inc.