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VIA ELECTRONIC DELIVERY

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RE: REQUEST FOR COMMENTS NOTICE 25-0001 – PROPOSED AMENDMENTS RESPECTING MANDATORY CLOSE-OUT REQUIREMENTS (the "Proposed Amendments")

Dear CSA/CIRO:

Virtu Canada Corp. appreciates the opportunity to provide our perspective on the Proposed Amendments and their potential impact on Canadian capital markets. Virtu Canada Corp. is the Canadian investment dealer arm of Virtu Financial ("Virtu"), a leading global provider of financial services and products that leverages cutting-edge technology to deliver liquidity to the global markets and innovative, transparent trading solutions to its clients.

Virtu and its subsidiaries operate as a market maker across numerous exchanges in Canada, the U.S. and elsewhere globally. Virtu's market structure expertise, broad diversification, and execution technology enable it to provide competitive bids and offers in over 25,000 securities, at over 235 venues, in 36 countries worldwide. Furthermore, Virtu operates an extensive ETF market making business, providing deep ETF block liquidity to institutional clients around the globe. In Canada, Virtu Canada Corp. maintains over 3,500 marketplace trading obligations on 2600 symbols and conducts inter-listed arbitrage activity on over 1500 symbols.

Additionally, Virtu' Execution Services business has long provided execution and workflow solutions to buy-side and sell-side clients, offering a robust suite of technology-driven services that support seamless and integrated market access, trade execution, workflow technology and analytics. These solutions, built to optimize Virtu's own trading infrastructure, have been leveraged globally by institutional clients on emerging and developed markets alike.

Discussion

Virtu supports the stated objectives of the Proposed Amendments, namely, to improve the perception of Canadian capital markets and encourage investment and listing activity. However, as a threshold matter, we do not believe the data supports introducing broad mandatory close-out requirements being proposed.

According to the Failed Trade Study published by IIROC in 2022[1], only fourteen percent of CNS fails are attributable to short sales. Moreover, settlement failures are more typically found on exchanges that list junior securities which are largely less liquid. This observation is supported in our own institutional client settlement data, where we see a greater prevalence of failed trades on junior, low-priced and illiquid securities. Notably, an analysis of Virtu's own settlement trade data indicates securities listed on TSXV, CSE or NEO are three to five times more likely to initially result in a failed trade as compared to TSX listed securities.

Separately, we note that the effect of the Reasonable Expectation of Settlement[2] amendments is not yet known, only becoming effective on April 4, 2025. We are concerned that the proposed amendments contemplated here have not considered the possible effects of the recent Reasonable Expectation of Settlement amendments. Any implementation of mandatory broad based close-out requirements must be carefully considered in the context of existing and upcoming rule changes given the potential for significant impact to Canadian capital markets.

With respect to the proposal itself, we are concerned that certain aspects of the proposal may adversely limit market making activity and reduce liquidity in Canadian capital markets. Additionally, while we generally support harmonization with the U.S. market where it makes sense to do so, the Canadian market is notably more concentrated among dealers and has a greater proportion of on-exchange trading, both of which must be considered in the context of the Proposed Amendments.

Thus, we believe CIRO should wait until the effects of the Reasonable Expectation of Settlements Amendments have been in place for some time and then perform an updated study of failed trades before any additional changes are made with respect to short sale regulation.

Market Making

Market Makers are critically important in supporting healthy Canadian capital markets and encouraging both investment and listing activity. In order to continuously offer a two-sided market, market makers must enter into short[3] positions as needed. Market Makers ability to turn over the inventories of long and short positions are primarily driven by the forces of supply and demand, which they do not control. While market makers may seek to control risk by ending the day flat, it is not uncommon for market makers to carry positions for longer periods, particularly on more illiquid securities. Market Makers frequently make markets in securities that may be listed on both a Canadian exchange and off-shore, make markets in instruments such as exchange traded funds that require hedging in the underlying portfolios of securities, and they otherwise provide liquidity to the market.

CIRO has proposed that SME market-making activities will generally be subject to a S+1 close-out requirement except for strategies related to marketplace trading obligations ("MTO") which is subject to a S+3 close-out requirement. We believe that providing extra days to market makers to close out is beneficial to the market given their important role in providing liquidity and promoting fair and orderly markets. However, we believe that limiting the relief to only those trades that are directly the result of a short sale related to the market makers MTO is unnecessarily restrictive and serves to remove liquidity from the market which is ultimately detrimental.

Moreover, unlike for example the US markets, where there are often multiple market makers in a given security such that if one market maker cannot accept short sales brokers can direct their orders to another, this mechanism does not currently exist in the same form in Canada, particularly for odd-lot trading which occurs on exchange pursuant to MTO assigned by the exchange to a given dealer (with the exception of non-MTO odd-lot trading on MATCHNow). The

[1] https://www.ciro.ca/media/3744/download?inline=1
[2] https://www.ciro.ca/newsroom/publications/amendments-respecting-reasonable-expectation-settle-short-sale
[3] This activity is generally marked Short-Marking Exempt (SME) on exchange

proposed amendments are also silent on how these marketplace assignments should be handled in a penalty box scenario. Generally, marketplaces are limited on their ability to adjust these assignments intra-day and once assignments are given up, they may be assigned to another firm permanently. At a minimum, additional guidance is needed in this area, including working with the marketplaces and dealers to develop a framework around marketplace trading obligations.

With respect to the concentration of the Canadian market, we note that only a handful of firms in the market today offer carrying broker services to introducing dealers. This naturally means that a given carrying broker may have multiple introducing brokers conducting market-making activity. We are concerned that the Proposed Amendments appear to impose pre-borrow restrictions on all introducing brokers of that carrying broker, even if the introducing broker was not allocated a fail-to-deliver position by the carrying broker. This has the potential to cause systemic liquidity issues for certain securities if multiple market makers were suddenly unable to enter into short positions[4]. We strongly encourage CIRO to further examine concentration in this area and consider allowing for introducing brokers to be unrestricted from entering short positions in instances where the introducing broker can demonstrate they were not the cause of their carrying broker failing to close-out short positions within the required timeline.

Questions and Responses

We have provided direct responses to the questions posed in the following pages:

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?

Answer:
Managing regulatory arbitrage is essential and any implementation must apply equally to all CDS Participants, as failing to do so will unfairly affect investment dealer members and would be patently uncompetitive. CIRO should not proceed with the amendments unless the CSA or CDS is able to mandate the requirements equally on all CDS participants. We believe unequal application of this rule would indeed encourage dealers to seek entities that are not regulated by CIRO for clearing purposes.

[4] While entering into a short position with a pre-borrow is technically allowed under the proposed amendments, in practice if the security was able to be borrowed the carrying broker would not have initially failed to meet the close-out requirement, and as such securities are highly unlikely to be available to borrow in this instance.

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*

Answer:
We believe that requiring the creation of specific records such that short positions be allocated to specific short sales made as part of MTO is burdensome and as stated above is ultimately not beneficial to the marketplace.

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?*

Answer:
Virtu is not a clearing member and as such from the perspective of an introducing broker we believe any allocation must be timely, and no later than 9am on the required close-out date. This is a minimum requirement to provide introducing brokers with enough time to close-out the fail-to-deliver position.

On the subject of timely close-outs, additional clarification is needed from CIRO if the close-out must be completed in the same manner as with Regulation SHO, i.e. generally in the opening auction or through a VWAP order entered pre-market and left uncancelled throughout the day. If the mandatory close-out amendments proceed, we would support harmonization with Regulation SHO in this area for operational efficiency.

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?*

Answer:
We support repealing the reporting requirement for extended failed trades. In our experience the vast majority of extended failed trades are related to either upstream settlement failures (i.e. where our client is a foreign broker dealer that is failing to receive from their upstream client in order to make onward delivery) or relating to corporate actions which take time to be properly processed in CDS. We believe neither of these common scenarios provides enough surveillance value for CIRO to warrant the ongoing additional administration and reporting cost for dealer members.

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?*

Answer:
We do not believe that the notification and reporting requirements should place an onus on executing or carrying brokers to restrict the activity of their originating investment dealer clients. Instead, the requirement to restrict future short sales should be placed on the originating investment dealer.

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?

Answer:
While allowing market makers to interact off-marketplace would likely have some value in encouraging timely close-outs, a potential on-market solution is to allow the execution of VWAP orders over the day instead of requiring the close-out strictly at 9:30am, which is consistent with Regulation SHO.

We note that none of the proposed options would necessarily be effective in minimizing market disruption of highly illiquid, micro-cap securities. Minimizing market disruption in these securities will run contrary to the objective of encouraging timely settlement.

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.*

Answer:
We do not support the introduction of a new marker for purchases executed in order to close out a fail-to-deliver position.

This would be a marked departure from Regulation SHO and it is not clear what surveillance benefits CIRO would gain from this marker to justify the development costs on dealers and vendors (which are ultimately born by the dealers). The proposed notification requirement appears sufficient to keep CIRO informed on the status of closing out positions.

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?

Answer:
One unique consideration not contemplated in the Proposed Amendments relates to the auto-execution facilities currently in place which provide market makers with automatically executed odd-lot trades (and thus potentially short positions) throughout the trading day. As these facilities operate without the market maker placing an actual short order on the marketplace, technical changes will be required in coordination with the marketplaces to modify or adjust these facilities on short notice if an odd-lot dealer comes under a pre-borrow requirement.

In speaking to some marketplaces, we understand that currently technical challenges exist in making changes intra-day to these facilities.

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.*

Answer:
We do not anticipate any challenge with meeting the proposed reporting and notification requirements.

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?*

Answer:
We agree that the extended close-out timeline of T+35 (and thus aligning with Regulation SHO) is appropriate for deemed to own securities.

QUESTION #11: *Are there other situations that would warrant an extended close-out timeline, and if so, what other exceptions should we consider?*

Answer:
As noted above, we submit that all SME activity should be permitted an S+3 close-out timeline. Please see our discussion above for further information on this point.

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?*

Answer:
In practice the pre-borrow requirement has the effect of restricting most if not all short selling. Where securities are available to borrow, they will generally be borrowed to prevent the pre-borrow requirement. That being said, maintaining the pre-borrow requirement instead of restricting short selling altogether still makes sense to harmonize with Regulation SHO.

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?*

Answer:
We support extending the reasonable expectation to settle requirement to investment dealer members that are not participants. In recent years we have seen an increase in Canada of non-participant investment dealers, in particular Order-Execution-Only firms, and these firms are in a much better position than their executing participants to be able to determine whether a given order has a reasonable expectation of settlement

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.*

Answer:
We believe some securities, in particular from junior and illiquid issuers, may occasionally experience a significant reduction in liquidity and other participants may not readily enter the market. These illiquid securities are thinly quoted at present and restricting market making firms from quoting these securities will impact the trading of these securities and ultimately result in greater market volatility which is contrary to the objectives of the proposed amendments.

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.*

Answer:
As noted above, we do not believe that there is sufficient justification today for mandatory close-out requirements. While this is now a long-standing practice in the U.S., key market structure differences in Canada call into question the potential benefit of such an approach. Please see our Discussion points above for further information on this question.

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.*

Answer:
Given the potential for significant technical and operational impacts, as well as coordination necessary between dealers and marketplaces, we suggest an implementation period of no less than one year.

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Virtu appreciates the opportunity to provide our perspective on these proposals and would welcome the opportunity to discuss further with CSA and CIRO staff.

Respectfully submitted,

Brandon Boyd
Chief Compliance Officer
Virtu Canada Corp.