

# CANADIAN SECURITIES ADMINISTRATORS SEEK INPUT ON ACTIVIST SHORT SELLING ACTIVITIES

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On December 3, 2020, the Canadian Securities Administrators (the “**CSA**”) issued CSA Consultation Paper 25-403 – Activist Short Selling (the “**Consultation Paper**”) seeking public consultation on a number of issues relating to activist short selling and its impact on Canadian public companies. **The CSA is accepting comments on the Consultation Paper until March 3, 2021.** If you have any comments relating to activist short selling and its regulation in Canada that you would like us to bring to the attention of the CSA, we urge you to please contact one of our firm’s Capital Markets lawyers.

## Activist Short Selling

Typically, activist short selling involves a person taking a short position in securities of a public issuer and then publicly disseminating an investment “thesis” – often referred to as a “short report” – attacking the public issuer as well as its management, public disclosures, business, operations and prospects. The activist short seller’s aim is to realize a trading profit by covering its short position once the trading price of the targeted public issuer’s securities has declined as a result of the short report. Proponents advocate that activist short selling contributes to market liquidity and efficiency in addition to facilitating price discovery and that added regulation would inhibit these benefits. In contrast, critics of activist short selling highlight its negative impact on public issuers and their shareholders, particularly those of issuers that have not yet become profitable and may be in need of additional capital in the near term. These critics also argue that in Canada, there is insufficient deterrence of abusive short selling conduct given limited enforcement mechanisms as well as the lack of meaningful sanctions for any misconduct.

## Consultation Issues

The CSA is seeking feedback from market participants and stakeholders to determine if short selling should be more robustly regulated in Canada and, if so, the appropriate manner of implementing any such added regulation. The Consultation Paper is seeking input on a number of matters including:

- the public perception of activist short sellers and examples of problematic conduct in the context of activist short selling campaigns;

- whether Canadian public issuers in comparison to those in other jurisdictions are more vulnerable to activist short selling;
- if the existing Canadian regulatory framework and disclosure regime are adequate to address the risks associated with problematic conduct by activist short sellers;
- whether there are limitations on a targeted public issuer's ability to respond effectively to an activist short selling campaign;
- if existing enforcement mechanisms adequately deter problematic activist short selling; and
- whether additional or different regulatory or remedial provisions should be considered or implemented to improve deterrence against problematic conduct.

### **CSA Research on Activist Short Selling in Canada**

A CSA Staff Committee undertook a combination of empirical analysis and a review of academic literature of activist short selling activities targeting Canadian issuers between 2010 and 2020 and found:

- a total of 73 Canadian issuers were the target of 116 activist short selling campaigns;
- 16 activist short selling campaigns, including all 12 launched in 2020, are currently active;
- the most active years during this period were 2018, 2016 and 2015, with 22, 21 and 19 campaigns in those years, respectively;
- annually, there have been less than 5 Canadian targets for every 1,000 Canadian listed issuers, compared with 21 U.S. targets for every 1,000 U.S. listed issuers;
- activist short sellers have gravitated toward issuers in sectors with perceived overvaluation. In 2018, there were activist short selling campaigns against 17 Canadian issuers, 6 of which were in the cannabis industry;
- activist short selling campaigns tend to be focused on larger issuers, with target issuers having an average market capitalization of \$4.5 billion and a median market capitalization of \$867 million;
- approximately 75% of target issuers experienced a negative price impact on the day of the first campaign announcement and up to one month after. The magnitude of the short-term price impact varied across targets and over time;
- approximately 40% of campaigns involved allegations of fraud, with the most common type of fraud allegation being a stock promotion or "pump and dump" scheme;
- in recent years, allegations of business issues including overleveraging and competitive pressures as well as general market overvaluation have become more common; and
- approximately 73% of the Canadian targets subject to activist short selling campaigns responded to the campaign.

## **Canadian Regulatory Framework, Enforcement and Remedies**

In most jurisdictions in Canada, activist short selling activities and the content of statements made by activist short sellers are not subject to specific securities regulation. Despite no specific regulation of short selling activities, there are broad prohibitions against market manipulation, market participants making misleading statements and fraud that could apply to short sellers.

Short selling activities are subject to the regulatory framework administered by the Investment Industry Regulatory Organization of Canada (“**IIROC**”). In particular, the Universal Market Integrity Rules (“**UMIR**”) administered by IIROC require a person placing an order to have a reasonable expectation of being able to settle the trade. In addition, securities laws and UMIR prohibit manipulative and deceptive trading activities.

Canadian securities law does not provide investors or issuers a manner to seek damages against an activist short seller for statements made in connection with an activist short selling campaign, unlike other jurisdictions including Australia. While issuers or investors may commence civil proceedings under common law against activist short sellers, there have been few Canadian cases dealing with activist short selling, which in itself raises questions about the likelihood of success of a litigant.

For a more detailed discussion of short selling and the Canadian regulatory framework, please consult our firm’s paper [An Analysis of the Short Selling Landscape in Canada: A New Path Forward is Needed to Improve Market Efficiency and Reduce Systemic Risk](#) published in October 2019 and referred to in the Consultation Paper.

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### **A Cautionary Note**

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

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