PROSPECTORS & DEVELOPERS ASSOCIATION OF CANADA

March 19th, 2021

M. Philippe Lebel
Corporate Secretary and Executive Director, Legal Affairs
Autorité des marchés financiers
Place de la Cité, tour Cominar
2640, boulevard Laurier, bureau 400
Québec (Québec) G1V 5C1

Sent via email: consultation-en-cours@lautorite.qc.ca; comments@osc.gov.on.ca

Re: CSA Consultation Paper 25-403 Activist Short Selling

Dear M. Lebel,

As the leading voice of Canada's mineral exploration and development community, the Prospectors & Developers Association of Canada (PDAC) represents more than 7,200 individual and corporate members, including a substantial portion of the nearly 1,200 mineral industry companies listed on Canadian exchanges.

It is encouraging to see the Canadian Securities Administrators (CSA) taking active steps to understand dynamics around activist short selling as it relates to issuers listed on Canadian exchanges, and commit to developing appropriate regulation and enforcement measures to address potential negative impacts. PDAC has identified several issues that CSA should consider for further investigation, and we provide a number of regulatory and enforcement-related recommendations for your consideration.

A key concern is the potential market imbalance created by limitations of issuers, particularly small and medium-sized companies, to rebut data or information provided to the public by activist short sellers. Thus, our recommendations are aimed at creating a level playing field for all market participants.

PDAC greatly values the opportunity to provide input to CSA members and has given careful consideration to the questions in the consultation. The accompanying appendix responds to questions posed by CSA, outlines recommendations developed by PDAC and our committee members, and we welcome continued engagement with CSA as this consultation progresses.

Sincerely,

Lisa McDonald

Executive Director

Prospectors & Developers Association of Canada

PROSPECTORS & DEVELOPERS ASSOCIATION OF CANADA

APPENDIX A: BACKGROUND & RECOMMENDATIONS

Preface

The mineral industry represents the largest cohort of public issuers in Canada and account for more than 1/3 of the companies listed on the TSX and TSXV exchanges. A relatively small portion of the sector are revenue generating mining companies with the majority being small to medium-sized exploration companies that rely heavily on issuing new equity via public markets to fund activities. There are inherent uncertainties in mineral exploration, low odds and high costs associated with discovering economically viable deposits and significant scoping work and stakeholder engagement required to develop a new mine.

With such a material proportion of issuers being largely dependent on complex technical information to base market valuations, and the need to issue equity on a recurring basis, Canadian markets have potential to become a target for unjustified shareholder activism and share price manipulation. As such, the importance of Canada's robust regulatory framework and disclosure standards cannot be understated. While short selling is an essential part of a balanced market, the nature of activist short selling should be monitored and well understood to ensure market imbalances do not manifest.

The remainder of this document provides recommendations for further research, the regulatory framework and enforcement as per the structure of CSA consultation paper 25-403.

Research and Empirical Findings (Q1-Q8)

Feedback from PDAC members reflects a perspective where short selling activity is seen as an integral part of a healthy market, providing additional liquidity for smaller companies, and a means to effect normal price discovery. In contrast, "activist" short sellers telegraph market positions and can exploit inherent uncertainties to amplify short theses publicly, without being based on concrete facts.

In the current state, regulations related to 'activist' short sellers are lacking and present similar risks to market participants as those posed by unregulated promotional activities. Hence, Canadian markets could benefit from a more rigid disclosure framework.

With regards to the less prominent activist short sellers: Currently it is very difficult to identify 'activists' and those engaged in 'short and distort' campaigns. Requiring an activist short seller to disclose positions (open to public view) could reduce the likelihood that "less prominent" activists conduct campaigns to distort a share price, particularly as it may relate to private placement offerings. At a minimum, this disclosure would provide more concrete data for regulators to monitor with respect to the impacts of activist short selling campaigns.

Empirical data sources to consider: PDAC recommends CSA review empirical data for companies where a declared short position exists prior to a financing being conducted, and analyse market

valuations at various points in time before and after a financing to gauge the potential impact of activist short selling.

Temporary drop in targeted Canadian issuers: The drop in the number of Canadian issuers targeted by prominent activist short sellers in 2019 was likely due to prevailing (strong) market conditions. A rebound in commodities, particularly gold and precious metals, helped to lift valuations across the mineral sector and create market conditions that are favourable for many resource companies as commodity prices. In this context, should macroeconomic conditions change and commodity prices trend downward, the number of activist short selling campaigns are likely to increase.

Vulnerability for activist short selling: Canadian markets may be more vulnerable for activist short selling due to the significant proportion of mineral sector companies listed on Canadian exchanges. A reliance on issuing new equity and with market valuations largely based on complex technical information, the mineral sector may be more exposed to activist short selling campaigns versus other sectors. Technical reports that are produced to evaluate assets (i.e. PEA/PFS/FS) have margins of error that can range from more than 30% to +/- 10% and this variance can be exploited by activity short selling campaigns. While the size and market liquidity of such pre-revenue companies may be a barrier for many short sellers, the concentration of issuers in this sector could make Canadian exchange more vulnerable.

Practical Limitations: Mineral exploration companies operate with very lean capital and human resources, which places significant practical limitations in terms of their ability to respond to allegations made in an activist short selling campaign, and can create punitive market imbalances.

Approaching regulators: Issuers are reluctant to approach securities regulators because there is little, if any, regulation in this area. Therefore, issuers feel there is limited recourse in approaching the regulators even if an activist short seller is spreading information which is lacking in credibility.

Regulatory Framework (Q9-Q11)

Existing regulatory frameworks could be improved to address risks associated with problematic activist short selling. There are limited rules that govern the way short selling campaigns are conducted, what information is disclosed and what assurances are provided. This reality provides a short seller with a degree of freedom to provide inaccurate information, or interpretations, with little possibility of any regulatory repercussions.

The implementation of Universal Market Integrity Rules amendments regarding short selling and failed trades was a positive step in dealing with short sales. However, since 2012 there have been significant developments that warrant revisiting the existing regulatory framework for short selling. Mostly, we would like to emphasize the substantial development of social media and the increase in ability to distort markets. PDAC's views is that this new reality requires all relevant regulators to update older rules and regulations to effectively address modern trading systems and strategies.

Specifically, we recommend CSA to develop a disclosure regime that addresses social media and other non-official promotion channels. Such a regime would be focused on both promoters and activist short sellers, in order to even the playfield for all market participants.

The existing disclosure regime is inadequate as it is not effective in preventing short selling campaigns. Therefore, PDAC recommends on adding disclosure requirements for both activist short sellers and stock promoters, including:

- Information on the position of the publisher of the report (e.g. size, date obtained, etc.); and
- Methodology / sources analysed in support of contradictory estimates or company valuations.

Lastly, in PDAC's view voluntary disclosure of a short position simply does not work, and recommend CSA consider implementing mandatory disclosure provisions for activist short sellers.

Enforcement and Remedies

In our view, it is difficult to ascertain the adequacy of existing enforcement mechanisms in deterring activist short selling because, to the best of our knowledge, very few (if any) enforcement actions have been taken against activist short sellers by Canadian regulatory agencies over the last decade. This stands in contrast to the U.S. and the Securities and Exchange Commission (SEC), which appear to be much more active in enforcing regulations and levying fines on bad actors in the market.

As markets continue to evolve technologically, with the advent of high-frequency and algorithmic trading and to mitigate the ability of short selling campaigns to distort markets, CSA should consider developing a regulation that is similar to SEC's Alternative Uptick Rule. This rule is designed to ensure investor confidence, market efficiency and mitigate potentially harmful impacts of short selling on the market. Such a Rule could similarly protect against bad actors from conducting activist short selling campaigns on Canadian exchanges.

While it may be only peripherally associated with activist short selling, many brokerage accounts allow the broker to loan shares owned by clients to a short seller, unbeknownst to its clients, and the lending brokers are presumably being compensated for such loans. This practice is clearly a conflict of interest and would seem to go against the 'Know Your Client' principles. CSA should consider creating a binding framework under which brokers will disclose potential use in clients' stocks for short selling, and provide them the option to opt out of share lending practices, whether the broker is providing shares to another broker or shares are being moved around within one brokerage entity

Lastly, it seems counterintuitive that market impacts must be recognized and used as a measure to trigger enforcement action by securities regulators as enforcement at its core is meant to preventing particular market activities. Applying a 'reasonable investor' standard may be a balanced approach to improving public disclosures, particularly for activist short sellers, without adding excessive burdens to market participants.