

TSXV

Trading Roundtable

TMX THE FUTURE IS YOURS TO SEE.

Overview

In March 2019, 19 stakeholders (representing listed companies, investors, traders, bankers, and regulators) gathered at a closed-door TSX Venture Exchange (TSXV) Trading Roundtable to discuss challenges and opportunities in Canada's public venture markets, and how we can strengthen our globally unique two-tiered capital markets.

Through its comments to the Canadian Securities Administrators (CSA) [↗](#), TSXV has addressed the topic of reducing burdens, so the particular focus of the trading roundtable was on structural considerations, driven by concerns heard from market participants.

TSXV organized the roundtable with the objective of soliciting feedback and recommendations from industry stakeholders to help reinforce (and, in some cases, renew) confidence in the Canadian trading environment for venture securities.

General Observations From Roundtable Participants

Participants pointed out that TSXV is the market for entrepreneurs and an important market for Canadian economic growth, fostering capital formation and providing companies of all sizes with access to public venture capital. However, some participants also remarked that there are opportunities to improve the trading marketplace for venture securities.

"TSXV is the last place left for entrepreneurs."

— participant comment

While participants acknowledged that some of the challenges are likely a function of macro shifts (e.g. the downturn in the mining sector, the movement to fee-based advice versus traditional stock picking), or changes to trading style or requirement (e.g. the increased use of algorithms (algos) as a tool for trading, and changes to short-selling rules), the participants' comments coalesced around four broad themes impacting Canada's markets for venture securities today:

- ① **Liquidity**
- ② **Regulation**
- ③ **Education**
- ④ **Transparency**

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Liquidity

The roundtable participants discussed whether a) wavering confidence has led to reductions in liquidity, or b) perceived reduction in liquidity is the result of wavering confidence in the market. Most participants agreed, however, that the less-liquid nature of venture securities seems to exacerbate problems with trading in those securities.

"Most of the issues are about a lack of liquidity which exacerbates some of the issues."

— participant comment

2

Regulation

The roundtable participants also debated the need for enhancements to regulation on certain trading practices, with some noting the need for additional regulation. However, other participants pointed out that additional regulation can hurt investment (in particular from foreign investors). As one buy-side participant argued, "don't protect us... no more regulation".

3

Education

Some participants commented that given the range of sophistication of those trading venture securities, and the extent of retail trading participation, there is a need to level the playing field with more accessible information about trading tools, venues, and rules.

"The problem is investors don't have experience [trading stocks]... the biggest harm is lack of education for investors."

— participant comment

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Transparency

Companies expressed concerns regarding certain mechanisms that can result in reduced transparency of trading and argued that addressing this could help improve investor confidence. One concern was aimed at the use of dark pools to trade venture securities. Traders in the room, however, argued that dark pools can benefit clients, including retail clients. Another concern discussed by roundtable participants was the use of the anonymous broker ID for trading.

"They [retail investors] don't know there are 10-15 trading venues..."

— participant comment

"Need greater transparency, no dark (pools) to increase volume... the more you can show, the more people will get comfortable."

— participant comment

"Brokers do not benefit from dark pools... a retail order will benefit from a better price."

— participant comment

Participant-Specific Concerns & Participant Recommendations

While liquidity, regulation, education, and transparency were underlying themes that emerged in the roundtable discussion, specific concerns were discussed and recommendations were made to address:

Trading Rules

Regulatory Gaps

Data Interpretation and Availability

Trading Rules

The nature of end-of-day trading was discussed by the group, as some issuers expressed concerns about end-of-day trading that can affect a security's price, often leaving management teams to explain what happened to investors. More specifically, short-selling and dark pools consumed much of the roundtable discussion about trading rules. Several participants also remarked that the reduced liquidity for many TSXV securities may magnify the effects of any shortcomings in trading structure.

During the discussion, it was mentioned that while people like to blame short-selling, it is also part of a healthy market. This point was not debated. Rather some participants offered some specific recommendations regarding short-selling that could improve confidence in venture securities trading. The recommendations related to two specific topics: short-selling on a downtick, especially towards the end of the day; and intentional covering of short positions with securities issued through private placements.

Short-selling on a downtick — Past IIROC research¹ had indicated that the 'tick test' was not an effective tool to restrict significant and rapid systemic declines in prices. IIROC removed the 'tick test' in 2012 on the basis of that and other research it had conducted on short-selling. However, some still argued that the market for venture securities is not large or liquid enough for unrestricted short-selling. Issuer participants advocated for having more conditions on the execution of a short sale. For example, it was suggested that shorting rules should be tied to the liquidity and/or size (market capitalization) of companies, to restrict short-selling in illiquid securities.

Private placements — There was also discussion about an investor's ability to cover short positions using securities issued through private placements. Specifically, participants referenced **Regulation M**² in the U.S. and asked why Canadian regulators have not adopted similar rules to restrict the covering of short sales with stock from private placements. There was some agreement among participants that, compared to the U.S., Canada is, "...missing one third of the rule".

"Shorting on a downtick" is the expression used to describe when a short sale occurs at a price that is lower than the price of the last trade in a security.

IIROC's "tick test" generally restricted the shorting of a security unless it was traded at the current price or higher than the last sale price.

1. See IIROC Technical Rules Notice 11-0077 - Price Movement and Short Sale Activity: The Case of the TSX Venture Exchange at http://www.iiroc.ca/Documents/2011/2360b592-c485-47d2-bc1d-d666bd9f1cc3_en.pdf#search=tick%20test

2. **Regulation M** restricts the ability to cover shorts using private placements. A further description of **Regulation M** can be found here - <https://www.sec.gov/about/offices/ocie/risk-alert-091713-rule105-regm.pdf>

Dark pools and dark trading — While much of the discussion about trading rules focused on short-selling, a debate was also raised about the benefits of dark trading. Some of the discussion indicated a lack of awareness of the important role that dark trading plays in the market. As mentioned, some companies raised concerns about the potential for dark trading to erode investor confidence because of the reduced pre-trade transparency. However, other participants saw benefits in dark trading, for example, where needing to reduce market impact for large and/or hard to trade orders, as well as for retail clients who can receive price improvement when trading against dark orders.

Trading Rule Recommendations from Roundtable Participants

Suggestions regarding trading rules were voiced by participants. They were to:

- A. Impose an equivalent to **Regulation M** in the U.S. (to prohibit covering short sales with stock from a private placement).
- B. Reinstate the 'tick test' for short-selling or enforce other short-sale restrictions based on metrics such as liquidity, size of company (market capitalization), or minimum trade size.

Regulatory Gaps

As mentioned earlier, the need for more regulation was not unanimously agreed upon by the roundtable participants. Nonetheless, three specific opportunities were discussed: improved regulation of trading from foreign jurisdictions; regulating certain messaging that is disseminated through social media; and regulating intentionally misleading short-seller reports.

Improved regulation of trading from foreign jurisdictions — Participants want to see an increase in foreign investment into Canada, yet a specific concern raised by some participants was that sometimes there is questionable trading practices from order flows originating in foreign jurisdictions. However it was pointed out that brokerage firms have a duty to act as gatekeepers by shutting-down investors with suspicious activity. Further, TSXV understands that where questionable trading is initiated from outside of Canada, IIROC partners with the CSA and other regulators are there to investigate this behaviour.

Regulating social media — It was commented that social media platforms create an imbalance in the dissemination of information. One participant noted, "individuals on my desk spend more time searching Twitter... it can be market-moving... we need some framework to at least get the info out there... [this will] calm some volatility."

Regulating intentionally misleading short-seller research reports — It was commented that intentionally misleading research reports are being published with impunity. Aside from the reports, one participant also suggested that regulators should investigate where there is undeclared shorting activity by examining who is lending securities and monitoring for disclosure.

Regulatory Gap Recommendations from Roundtable Participants

Three suggestions regarding regulatory changes were voiced by participants:

- A. Tightening regulation over and enforcement of questionable trading by foreign entities.
- B. An ongoing review and enforcement of the regulatory framework around disclosure through social media.
- C. Policing of intentionally misleading short-seller publications.

Data

The discussion among participants about data centered around: better price disclosure; trading volume disclosure; and anonymous trading activity.

Better price disclosure — A few participants made the comment that a company's closing price, while the main reference for investors, is not always indicative of a security's value. As one company executive noted, "We can have a beautiful green day of trading... and yet at the very end of the day there is one sale on a downtick and this very small trade size can close the stock on a downtick."

Trading volume disclosure — Another topic raised is the perception of lower trading volume due to the fragmentation of trades across multiple trading platforms. One roundtable participant noted that "many people don't know or see half the daily volume", while another indicated that the "current practice understates liquidity."

Anonymous trading activity — A participant also commented on the use of the anonymous trading attribution. Although the point was made that prior to the anonymous trade option, traders used the jitney function for similar effect, some still felt that anonymous trading does not help investor confidence.

Currently there are 14 venues in Canada that trade securities listed on TSX Venture Exchange.

Anonymous trading in TSXV-listed securities represents approximately 25% of market-wide volume for TSXV securities, and is consistent with the percentages observed for TSX-listed securities.

Data Recommendations from Roundtable Participants

There were three suggestions made by participants regarding the representation of data:

- A. Provision and distribution of an intra-day VWAP along with the closing price.
- B. Providing Canadian aggregate volume and end-of-day last sale price information for TSXV securities.
- C. Earlier disclosure of anonymous trading reports.

Conclusions and TSXV Position

Overall, TSXV heard the challenges expressed by participants and acknowledged that these are pronounced by the lower levels of liquidity more typically associated with venture securities. These challenges can appear not only on TSXV, but across all Canadian trading venues. TSXV is committed to helping and continuing to listen to the suggestions made by our market participants.

The specific recommendations from the roundtable participants cannot be considered singularly as TSXV issues to resolve. Instead, all the relevant Canadian regulatory bodies (including TSXV, the CSA, and IIROC) must take careful consideration of the recommendations in light of their specific mandates and stakeholders.

In response to the feedback from the roundtable participants, TSXV concludes the following:

- 1. Regulation M:** TSXV will review Regulation M with the CSA and IIROC to understand its potential relevance to the Canadian market.
- 2. Short-selling:** TSXV will consult with the CSA and IIROC on the potential for a re-evaluation of short-selling rules for TSXV-listed securities. The re-evaluation could be used to determine whether the tick test should be reinstated, or whether other short-sale restrictions may be warranted.
- 3. Trading from outside of Canada:** TSXV is not responsible for the direct enforcement of trading regulation but believes that Canadian regulators monitor and enforce trading from domestic and foreign sources effectively. TSXV agrees that regulators and brokerage firms need to maintain their responsibility and gatekeeping duties over participants no matter the jurisdiction of the original investor.
- 4. Dark trading:** TSXV believes that, if properly regulated, dark trading can be a useful option for certain investors, but we recognize that providing more education might help address concerns and misconceptions.
- 5. Data:** TSXV will investigate options for providing alternative pricing data on its data platforms. TSXV also recognizes the importance of providing more education to investors and issuers about how to access consolidated (all Canadian trading venues) trading data on TMX platforms.
- 6. Intentionally misleading publications:** TSXV believes that the policing of intentionally misleading research reports and company disclosure is important and notes that this is a critical issue that every major capital market globally is facing. TSXV is supportive of the CSA's efforts to investigate and regulate intentionally misleading short-selling research and company disclosure.

In addition, as part of ongoing market improvement, TSXV will work with stakeholders and regulators to do the following:

①

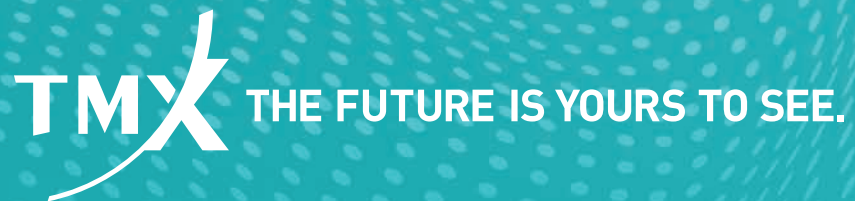
Evaluate an option for TSXV-listed issuers to trade on the "home market only" in order to reduce fragmentation of trading activity, provide greater transparency to investors, and provide TSXV with better visibility on market participant activity.

②

Offer additional education and insights to issuers on trading and trading practices through our continuing education programs.

③

Continue to listen to other suggestions from clients and industry participants and work with other regulatory partners to address the recommendations put forward by the roundtable participants. Stakeholders with feedback are invited to submit ideas to venturefeedback@tmx.com.



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