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VIA E-MAIL

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BRITISH COLUMBIA SECURITIES COMMISSION
FINANCIAL AND CONSUMER AFFAIRS AUTHORITY OF SASKATCHEWAN
FINANCIAL AND CONSUMER SERVICES COMMISSION (NEW BRUNSWICK)
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NOVA SCOTIA SECURITIES COMMISSION
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OFFICE OF THE SUPERINTENDENT OF SECURITIES, NORTHWEST TERRITORIES
OFFICE OF THE YUKON SUPERINTENDENT OF SECURITIES
ONTARIO SECURITIES COMMISSION
SUPERINTENDENT OF SECURITIES, DEPARTMENT OF JUSTICE AND PUBLIC SAFETY, PRINCE
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Dear Sirs/Madams:

Re: Shared Mortgages and Report of Exempt Distribution

Further to our recent conversations with Mr. Lanion Beck from the Alberta Securities Commission and in light of the Canadian Securities Administrators' proposed amendments to National Instrument 45-106 (the "Instrument"), we confirm that we are writing this letter to further explain the commercial lending and commercial mortgage brokering industry, provide comments on issues we have found with the requirement to file a Report of Exempt Distribution under Section 6 of the Instrument pertaining to this industry, and provide some potential solutions for the ASC and CSA to consider.

1. Report of Exempt Distribution under National Instrument 45-106

As you know, depending on which prospectus exemption is relied on, a Report of Exempt Distribution may be required to be filed under Section 6.1, unless there is an exception available under Section 6.2 or otherwise within the Instrument.

Distributions made under the exemption for mortgages in Section 2.36 are exempt from the requirement to file a Report of Exempt Distribution. However, this exemption only applies when there is one lender as the section states:

2.36 (1) In this section, "syndicated mortgage" means a mortgage in which 2 or more persons participate, directly or indirectly, as a lender in a debt obligation that is secured by the mortgage.

(2) Except in Ontario, and subject to subsection (3), the prospectus requirement does not apply to a distribution of a mortgage on real property in a jurisdiction of Canada by a person who is registered or licensed, or exempted from registration or licensing, under mortgage brokerage or mortgage dealer legislation of that jurisdiction.

(3) In Alberta, British Columbia, Manitoba, Québec and Saskatchewan, subsection (2) does not apply to a distribution of a syndicated mortgage.

2. Shared Mortgages Versus Syndicated – Timing Issue

Section 2.36 defines syndicated mortgages as those mortgages in which 2 or more persons participate as a lender. However, the section offers no guidance on the timing as to when the participation occurs.



In the general view of the lending industry, mortgages are not "syndicated" simply because there are 2 or more lenders involved; instead, the lending industry generally refers to these mortgages as "shared mortgages". Where 2 or more lenders participate in the making of a mortgage loan, this should not generally be considered to be a syndicated loan. Typically the industry views syndicated loan mortgages to be mortgage loans that are distributed by a lead lender to other lenders after the mortgage loan is made. A mortgage loan is "made" at the time that the commitment letter between the lender and the borrower is signed, and this timing issue is critical. When a borrower signs a commitment letter with a single lender, the legal relationship of lender and borrower is created at that time, and whether or not the lender then proceeds to sell interests in the loan/mortgage to third parties is irrelevant and is beyond the control (and often without the knowledge) of the borrower.

Therefore, the imposition of a set of rules which brand all mortgage loans by co-lenders to be syndicated mortgaged or which assume that the borrower is the syndicating party does not reflect the reality of the industry. Shared mortgage loans should not require securities regulation.

3. Issues for Lending Industry Relating to Report of Exempt Distribution

In addition to taking issue with the definition of syndicated mortgages pursuant to National Instrument 45-106 and highlighting the distinction between syndicated mortgages and shared mortgages (as noted above), we would also take this opportunity to explain the practical issues that arise for the commercial lending industry based on the current definition of syndicated mortgages in National Instrument 45-106.

The vast majority of loans made in the commercial lending industry are made by accredited investors who can rely on the prospectus exemption set out for accredited investors in Section 2.3 of the Instrument. However, distributions under Section 2.3 are not exempt from filing the Report of Exempt Distribution under Section 6.1, and this is where the issue arises. While the issue is partially remedied by Section 6.2, many lenders are still negatively affected.

Section 6.2 of the Instrument has an exemption from the filing requirement for the Report of Exempt Distribution. The relevant Sections of the Instrument state as follows:

6.2 (1) An issuer is not required to file a report under section 6.1(1)(a) [*Report of exempt distribution*] for a distribution of a debt security of its own issue or, concurrently with the distribution of the debt security, an equity security of its own issue, to a Canadian financial institution or a Schedule III bank. [*emphasis added*]



"Canadian financial institution" means:

- (a) an association governed by the *Cooperative Credit Associations Act* (Canada) or a central cooperative credit society for which an order has been made under section 473(1) of that Act, or
- (b) a bank, loan corporation, trust company, trust corporation, insurance company, treasury branch, credit union, caisse populaire, financial services cooperative, or league that, in each case, is authorized by an enactment of Canada or a jurisdiction of Canada to carry on business in Canada or a jurisdiction of Canada;

"Schedule III bank" means an authorized foreign bank named in Schedule III of the *Bank Act* (Canada).

Many lenders in the commercial lending industry fall under the definition of accredited investor, but do not fit within the definition of a Canadian financial institution or a Schedule III bank. As a result, loans made involving these types of entities are disadvantaged when compared to loans made by Canadian financial institutions, due to the requirement for someone to file a Report of Exempt Distribution with the ASC and pay the prescribed fee, which can be a substantial sum of money when dealing with large commercial mortgage loans.

4. Industry Background

a) General Background

As discussed, the majority of commercial mortgages are funded by more than one lender. It is quite common for a lender to commit to lending money to a borrower and then to reduce its risk by selling portions of the loan to other lenders, hence sharing the risk. The loan stays in the name of the original lender, and the original lender enters into a servicing and/or inter-lender agreement with the original lender and any other lenders to allocate the risk and manage the relationship.

It is important to note that lenders involved in these types of transactions are often Canadian financial institutions or Schedule III banks; however, there are many other types of accredited investors with significant assets that are frequently involved in these shared mortgage loans that do not fall under this definition, such as pension funds, mortgage funds, or mortgage investment corporations. Loans involving these types of lenders that do not fall into the Section 6.2 exemptions are distinctly disadvantaged when compared to shared loans made by those who do, due to the requirement to file a Report of Exempt Distribution and pay the substantial filing fee.



b) Size of Market

Most office buildings, large commercial shopping centres and large commercial warehouse developments are funded through these types of shared loans. In fact, it is fair to say that most commercial mortgage loans in amounts of more than \$50 million are shared by at least two lenders.

c) Substantial Non-Compliance

Although there are many multi-lender mortgages involving accredited investors that are not Canadian financial institutions or Schedule III banks, we anticipate that the ASC receives very few, if any, Reports of Exempt Distribution in relation to these loans. We understand that the ASC has taken the position that the borrower (not the lender who is selling portions of the loan) is required to file the Report of Exempt Distribution in these situations; however, this is not practical from the borrower's perspective, as the borrower will likely not have the knowledge that the loan has been shared and has no control over whether or not the loan is shared by multiple lenders for the following reasons:

i) Borrower's Inability To Control Whether Or Not The Loan Is Sold In Whole Or In Part

From the borrower's perspective, the lender is the party that the borrower initially received a commitment letter from, and the borrower may never know that there is more than one lender involved in the loan.

Additionally, the borrower will have no control over whether or not the lender has sold off interests in the loan to other lenders in order to ultimately share its risk as the lender's interest in a mortgage is assignable without the borrower's consent.

ii) The Loan Can Be Sold At Any Time

The transfer of all or any portion of a loan secured by a mortgage can occur at any time. It could occur immediately after a commitment letter is signed between a borrower and a single lender or any time before or after the loan is funded, including years after the loan is funded. Lenders are constantly managing, evaluating, and adapting their risk portfolios based on the current mortgages they hold and this often results in them selling off a portion of their loans to third party lenders either before or after the funds are advanced.



5. Potential Solutions

a) **Shared Mortgages and Requirement to File Report of Exempt Distribution**

We have considered some alternative methods to address the above noted issue and conclude that amending Section 2.36 of the Instrument is the most efficient and likely the most palatable from the ASC's perspective. By making some relatively simple changes to this section, the ASC would be able to ensure that shared loans involving sophisticated lenders of all types fall under this exemption, and are therefore not required to file Reports of Exempt Distribution. We propose the following addition to section 2.36, as italicized:

2.36 (1) In this section, "syndicated mortgage" means a mortgage in which 2 or more persons participate, directly or indirectly, as a lender in a debt obligation that is secured by the mortgage.

(2) Except in Ontario, and subject to subsection (3), the prospectus requirement does not apply to a distribution of a mortgage on real property in a jurisdiction of Canada by a person who is registered or licensed, or exempted from registration or licensing, under mortgage brokerage or mortgage dealer legislation of that jurisdiction.

(3) In Alberta, British Columbia, Manitoba, Québec and Saskatchewan, subsection (2) does not apply to a distribution of a syndicated mortgage, *unless the syndicated mortgage is held by lenders that are permitted clients pursuant to National Instrument 31-103.*

Note that we have included the definition of permitted client from National Instrument 31-103 as Schedule "A" for your ease of reference.

The above noted amendment will assist with accomplishing 2 objectives:

- 1) All "sophisticated" lenders will be placed on a level playing field, and consequently borrowers that borrow from sophisticated lenders that do not fall within the scope of the definition of "Canadian financial institutions" or Schedule III banks will not be inadvertently disadvantaged due to having to file a Report of Exempt Distribution and pay the significant filing fee. Therefore, all sophisticated lenders will remain equally desirable on this basis.
- 2) Substantial non-compliance with the Instrument in the commercial lending industry will be significantly reduced.

b) **Put Onus on Lenders to File Report of Exempt Distribution**



While we understand that the ASC currently takes the position that the borrower is required to file the Report of Exempt Distribution in situations where a filing is required, this is not practical, as the borrower:

- (i) is not the party that is sharing the mortgage;
- (ii) does not have any control over whether or not a mortgage is shared; and
- (iii) is likely not aware that the mortgage is shared between lenders after the commitment letter has been signed.

Therefore, the only way the ASC can reasonably have an expectation of shared loans being dealt with in compliance with the Instrument and requiring Reports of Exempt Distributions to be filed if the exemptions available under Section 6.2 do not apply, is to place the onus on the lender to file the report.

We look forward to discussing this matter with you at your convenience and we thank you for your time and attention to this matter. I can be reached at 780-497-4896.

Yours truly,

BROWNLEE LLP

ROGER I. SWAINSON

c.c. Alberta Securities Commission – Lanion Beck
Brownlee LLP – Graeme Swainson



SCHEDULE "A"

From National Instrument 31-103:

"permitted client" means any of the following:

- (a) a Canadian financial institution or a Schedule III bank;
- (b) the Business Development Bank of Canada incorporated under the Business Development Bank of Canada Act (Canada);
- (c) a subsidiary of any person or company referred to in paragraph (a) or (b), if the person or company owns all of the voting securities of the subsidiary, except the voting securities required by law to be owned by directors of the subsidiary;
- (d) a person or company registered under the securities legislation of a jurisdiction of Canada as an adviser, investment dealer, mutual fund dealer or exempt market dealer;
- (e) a pension fund that is regulated by either the federal Office of the Superintendent of Financial Institutions or a pension commission or similar regulatory authority of a jurisdiction of Canada or a wholly-owned subsidiary of such a pension fund;
- (f) an entity organized in a foreign jurisdiction that is analogous to any of the entities referred to in paragraphs (a) to (e);
- (g) the Government of Canada or a jurisdiction of Canada, or any Crown corporation, agency or wholly-owned entity of the Government of Canada or a jurisdiction of Canada;
- (h) any national, federal, state, provincial, territorial or municipal government of or in any foreign jurisdiction, or any agency of that government;
- (i) a municipality, public board or commission in Canada and a metropolitan community, school board, the Comité de gestion de la taxe scolaire de l'île de Montréal or an intermunicipal management board in Québec;
- (j) a trust company or trust corporation registered or authorized to carry on business under the Trust and Loan Companies Act (Canada) or under comparable legislation in a jurisdiction of Canada or a foreign jurisdiction, acting on behalf of a managed account managed by the trust company or trust corporation, as the case may be;
- (k) a person or company acting on behalf of a managed account managed by the person or company, if the person or company is registered or authorized to carry on business as an



adviser or the equivalent under the securities legislation of a jurisdiction of Canada or a foreign jurisdiction;

- (l) an investment fund if one or both of the following apply:
- (i) the fund is managed by a person or company registered as an investment fund manager under the securities legislation of a jurisdiction of Canada;
 - (ii) the fund is advised by a person or company authorized to act as an adviser under the securities legislation of a jurisdiction of Canada;
- (m) in respect of a dealer, a registered charity under the Income Tax Act (Canada) that obtains advice on the securities to be traded from an eligibility adviser, as defined in section 1.1 of National Instrument 45-106 Prospectus and Registration Exemptions, or an adviser registered under the securities legislation of the jurisdiction of the registered charity;
- (n) in respect of an adviser, a registered charity under the Income Tax Act (Canada) that is advised by an eligibility adviser, as defined in section 1.1 of National Instrument 45-106 Prospectus and Registration Exemptions, or an adviser registered under the securities legislation of the jurisdiction of the registered charity;
- (o) an individual who beneficially owns financial assets, as defined in section 1.1 of National Instrument 45-106 Prospectus and Registration Exemptions, having an aggregate realizable value that, before taxes but net of any related liabilities, exceeds \$5 million;
- (p) a person or company that is entirely owned by an individual or individuals referred to in paragraph (o), who holds the beneficial ownership interest in the person or company directly or through a trust, the trustee of which is a trust company or trust corporation registered or authorized to carry on business under the Trust and Loan Companies Act (Canada) or under comparable legislation in a jurisdiction of Canada or a foreign jurisdiction;
- (q) a person or company, other than an individual or an investment fund, that has net assets of at least \$25 million as shown on its most recently prepared financial statements;
- (r) a person or company that distributes securities of its own issue in Canada only to persons or companies referred to in paragraphs (a) to (q);