May 14, 2019

Alberta Securities Commission
Autorité des marchés financiers
British Columbia Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Financial and Consumer Services Commission (New Brunswick)
Manitoba Securities Commission
Nova Scotia Securities Commission
Nunavut Securities Office
Office of the Superintendent of Securities Newfoundland and Labrador
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 Edward Island

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Dear Sirs/Mesdames:

Re: CSA Second Notice and Request for Comment on Proposed Amendments to National Instrument 45-106 *Prospectus Exemptions* and National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* relating to Syndicated Mortgages and Proposed Changes to Companion Policy 45-106CP *Prospectus Exemptions* and Companion Policy 31-103CP *Registration Requirements, Exemptions and Ongoing Registrant Obligations*

The Private Capital Markets Association of Canada ("**PCMA**") is pleased to provide our comments in connection with the Canadian Securities Administrators' ("**CSA**") Proposed Amendments to National Instrument 45-106 *Prospectus Exemptions* and National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* relating to Syndicated Mortgages and Proposed Changes to Companion Policy 45-106CP *Prospectus Exemptions* and Companion Policy 31-103 CP *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (the "**Proposal**") as set out below.

About the PCMA

The PCMA is a not-for-profit association founded in 2002 as the national voice of the exempt market dealers ("**EMDs**"), issuers and industry professionals in the private capital markets across Canada.

The PCMA plays a critical role in the private markets by:

- assisting hundreds of dealer and issuer member firms and individual dealing representatives to understand and implement their regulatory responsibilities;
- providing high-quality and in depth educational opportunities to the private capital markets professionals;
- encouraging the highest standards of business conduct amongst its membership across Canada;
- increasing public and industry awareness of private capital markets in Canada;
- being the voice of the private capital markets to securities regulators, government agencies and other industry associations and public capital markets;
- providing valuable services and cost-saving opportunities to its member firms and individual dealing representatives; and
- connecting its members across Canada for business and professional networking.

Additional information about the PCMA is available on our website at www.pcmacanada.com.

The first section of the letter presents our general comments on the Proposal, followed by responses to specific questions asked in the Proposal.

General Comments on Proposed Amendments

Mortgage syndication is integral to the mortgage industry as it promotes investor protection by allowing investors to build a custom, diversified mortgage portfolio. Furthermore, some mortgage investment entities ("**MIEs**") use mortgage syndication to mitigate risk by reducing loan concentration and increase liquidity in their pooled funds. It is paramount that the regulations governing syndications pragmatically balance investor protection and business efficiencies.

The PCMA welcomes the Proposal and its intent to enhance investor protection and improve national regulatory harmonization. However, we note several concerns with the Proposal, including:

1. There are potential issues from having syndicated mortgages being regulated by two separate regulators. This will increase regulatory costs and create the potential for investor confusion and regulatory arbitrage.

2. The definition of non-qualified syndicated mortgages ("**NQSM**") draws an arbitrary line down the middle of the industry. Some lenders offer both qualified syndicated mortgages ("**QSM**") and NQSM and investors do not currently distinguish between the two. This means that some lenders and investors will have two sets of regulations to adhere to for what they would currently consider to be a homogenous asset class.

3. The regulatory cost burden associated with filing a Form 45-106F1 *Report of Exempt Distribution* ("**Report of Exempt Distribution**") for each syndicated mortgage could be prohibitive and has the potential to drastically reduce the number of syndicated mortgages

available for investors. It is possible that the fee burden will be high enough that the only NQSM offered to retail investors will be for riskier large-scale developments.

4. There are several potential unintended consequences for both mortgage funds and sophisticated investors. Often lenders will share deals between each other if the deal is too large for one lender to fund alone. Such a transaction would constitute a syndicated mortgage distribution under the Proposal and require the filing of a Report of Exempt Distribution. This will be most acute for mortgage funds that are distributed through a non-captive EMD who they will have to pay as well to facilitate the transaction. The Proposal could also drastically reduce the ability of sophisticated investors to build a custom mortgage portfolio through syndication.

Advocating for a Single Regulator Regime

The PCMA believes that the goal of increasing investor protection for syndicated mortgages is best achieved by having a single regulator oversee all mortgage capital raising activities regardless of the characteristics of the mortgage or if it is done via syndications or a fund structure. The benefits of a mono-regulatory regime are as follows:

- **Reduces regulatory inefficiencies and related costs.** A dual regulator regime will likely result in duplication of licencing, insurance costs, unimpaired working capital requirements and increased administration. We note that provincial regulators have made regulatory reduction part of their mandate but we are concerned that the benefits of their individual efforts will be countered by the results of operating within a dual regulatory eco-system.
- **Reduces administrative burden on investors.** Often investors participate in both fund products as well as mortgage syndication. As is the case in the current regulatory environment, dual regulators have resulted in the duplication of know your client ("**KYC**") and suitability procedures for investors. It should be noted that the prescribed Financial Services Commission of Ontario investor forms are difficult to also utilize for KYC and suitability purposes under the OSC's regime as the forms are designed for a syndicated product. The requirement to fill out different forms for different types of syndicated mortgage has created confusion on the part of the investor.
- **Avoids the potential for regulatory arbitrage.** If there is inequality regarding licencing proficiencies and on-going regulatory obligations, bad actors will target the regulator with less regulatory oversite; a reality that recently occurred with a high-profile mortgage syndicator. Moreover, if the requirements are on par, then a question is raised as to the point of having two regulators.
- **Easier path to harmonization:** The PCMA supports the CSA's goal of achieving harmonization but has concerns that the Proposal fails to establish the most effective foundation to do so. If the Proposal is adopted as suggested, there will be four regulatory bodies, the Ontario Securities Commission ("**OSC**"), the British Columbia Securities Commission ("**BCSC**"), the Financial Institutions Commissions ("**FICOM**") and the Financial Services Regulatory Authority of Ontario ("**FSRA**"), all regulating capital raising for mortgages for Canada's two largest markets. Regulatory jurisdictions that are further fractured by subdividing syndicated mortgages between the OSC/BCSC and FSRA/FICOM. The proposed model is complicated and creates difficulties for national adoption and also results in the aforementioned concerns. Comparatively, having a single

regulator, as is the case in Alberta, creates a streamlined structure that is better suited for duplication. We further note that:

- There is no pragmatic reason for regulatory variances amongst the provinces as the underlying product and investor protection requirements has no correlation with specific provinces.
- Dividing up mortgages based upon syndicated versus pooled fund offerings has historically led to regulatory arbitrage. Furthermore, it is an academic division as syndicated mortgage investors often diversify their mortgage investments effectively creating their own “fund” portfolios.
- Instilling a sufficient investor protection regime should be based on the proficiencies of the dealer/broker not the underlying product. An ill-equipped dealer/broker will fail to safeguard the investor regardless of the simplicity of the offering.

A Better Definition of Non-Qualified Syndicated Mortgage

In recent years there have been investments marketed as secured syndicated mortgages, where the risk of the investment was much more akin to an equity investment in a large construction development deal. The risks associated with these investments were often not properly disclosed to or understood by investors who erroneously believed the loans were fully backed by real estate when in fact, having loans-to-value far in excess of 100%, they were not.

We fully stand behind the CSA’s goal to draw a line between these investments and true syndicated mortgages. However, the current definition of NQSM is far too broad and arbitrary. There are plenty of instances where a mortgage on a commercial property or for construction purposes is less risky than a residential mortgage, as the riskiness of a mortgage is dependant as much on property type as it is on loan-to-value, geography of the loan and the borrower’s history, credit rating and net worth.

A better definition of NQSM would capture:

- Negotiated or arranged through a mortgage brokerage;
- At the time the syndicated mortgage is arranged, the amount of debt it secures, together with all other debt secured by mortgages on the property that have priority over, or the same priority as, the syndicated mortgage, does not exceed 90% of the fair market value of the property relating to the mortgage, excluding any value that may be attributed to proposed or pending development of the property;
- It is limited to one debt obligation whose term is the same as the term of the syndicated mortgage; and
- Aside from reasonable administration fees, the rate of interest payable under the mortgage is equal to the rate of interest payable under the debt obligation.

Furthermore, we feel that revising the definition of NQSM would mitigate many of the other concerns we have with the Proposal.

Reports of Exempt Distributions

We request clarity as to why the timing of the Report of Exempt Distribution is out of the scope of this project. To many lenders, the Report of Exempt Distribution represents one of the larger financial and administrative costs associated with the Proposal.

The response that the expectation that the cost of filing is minor compared to the cost of registration of a mortgage fails to capture the realities of operating a syndicate portfolio. For starters, there is an industry expectation that the costs associated with registering a mortgage are borne by the borrower from the proceeds of the mortgage. Second, it is a one-time cost which allows it be to accounted for when determining the total loan amount. Conversely, a syndicate mortgage can require multiple Report of Exempt Distributions and it is often difficult to predict the frequency as new investors are often added to a mortgage throughout the course of the loan's terms. Furthermore, construction mortgages which may include 4+ draws and have different investors participate in each draw could also trigger multiple reports. These issues are multiplied in the context of a managing a syndicate portfolio and are particularly burdensome for small to medium lenders whose investors maintain small investment amounts diversified across multiple small loans with short terms.

To illustrate the implications of imposing a $500 filing fee, we use a $200,000 mortgage loan. A lender would likely earn between $2,000 to $4,000 in fees on a loan of this nature. Having to file a Report of Exempt Distribution and pay $500 each time a syndicated investor participates could amount to consuming the entire revenue with regulatory filing fees.

In order to reduce the administrative burden and expense while still ensuring that the CSA remains up to date, we recommend an annual filing for Form 45-106F1 – *Report of Exempt Distribution* for all syndicate mortgages. The CSA currently allows investment funds distributed under prospectus exemptions to file annually, but all other exempt distributions have to be filed within 10 calendar days. This is costly and time consuming and for the aforementioned reasons is in particular burdensome for syndicate mortgages given the nuances of the product.

As an aside, we maintain that determining who the issuer is remains unclear, even with the additional commentary provided, and we request further clarification on this matter. It is imperative that both issuers and regulators have a clear and shared understanding to avoid fragmented implementation and oversight.

Reducing Cost Burden and Unintended Consequences through a Carve Out For Permitted Investors

As previously stated, the Proposal has the potential for unintended consequences for mortgage funds and sophisticated syndicated mortgage investors. A solution that would provide some mitigation is to adopt a prospectus exemption for syndicated mortgages distributed to permitted investors. We do not believe that permitted investors require the additional protection that the Proposal aims for and that the changes will only be a detriment to them. Furthermore, this would help in the CSA's harmonization goals as this is currently being offered in B.C. and is being proposed for Alberta.

Risks of Syndicate Mortgages and Comparisons to Other Securities.

We maintain that syndicate mortgages are being blanketly miscategorized as high-risk investments which has an adverse impact on suitability analysis and unjustly portrays the industry negatively.

Syndicated mortgages represent a diverse array of loans that can encompass residential standard first mortgages with conservative loan to values and complicated commercial development with aggressive loan to values and in a subordinated position. Subsequently, determining the risk characteristics of the asset class should be assessed on a per loan basis as all-encompassing statements fail to capture the nuances.

We further note that the CSA's response in the Proposal reaches an erroneous conclusion as it states that 6.6% of the reported syndicated mortgages resulted in a loss. Rather, according to the Proposal, only 3.8% of the 2,000+ mortgages led to a loss of some principal or interest. Even assuming the higher figure of 6.6%, results in an asset class wherein 93.4% of the total loans preformed. Such data should support the conclusion that an individual syndicated mortgage or a portfolio comprising of lower risk private mortgages can be categorized as low-medium risk.

We also maintain that there is no pragmatic reason as to why mortgages should be treated differently than other securities and we request insight as to why they are being segregated. The conceptual nature of the segregation of mortgages is evident when examining the regulatory obligations of other securities. For instance, issuers of bonds and debentures who collateralize their security with a mortgage results in a product that is substantially the same as a mortgage however they are subject to different regulatory oversight (i.e. the permitted use of the private issuer exemption). The atypical treatment of mortgages is not only creating additional regulatory obligations it is also impeding national harmonization as each province is adopting nuanced regulations for their jurisdictions.

Adopting the Existing Local British Columbia Exemptions.

We note that Ontario is looking to adopt exemptions similar to Commission Rule 45-501 (BC) *Mortgages*. As previously mentioned, doing so introduces unnecessary regulatory duplications and confusion when compared to having one regulator oversee all mortgage capital raising activities. In the event that a single regulator model is not adopted we request that the definition as previously outlined of a QSM is adopted.

Furthermore, the definition should allow administrators to charge an administration fee. We note that Ontario did not adopt the B.C. provision that carves out administrators' fees as Ontario's definition of a QSM states that an investor needs to earn the face rate of the loan. We maintain that in doing so, mortgages that are not intended to be categorized as NQSM are being categorized as such as a result of an administrators' business models and not the underlying characteristics of the loan.

Closing Remarks

The PCMA would like to thank to the CSA for their efforts in drafting the Proposal and for soliciting feedback from various stakeholders.

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We thank you for considering our submissions and we would be pleased to respond to any questions or meet with you to discuss our comments.

Yours truly,

COMMENT LETTER COMMITTEE MEMBERS

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