



September 30, 2016

Alberta Securities Commission
Autorité des marchés financiers
British Columbia Securities Commission
The Manitoba Securities Commission
Financial and Consumer Services Commission (New Brunswick)
Nova Scotia Securities Commission
Ontario Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan

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Re: CSA Consultation Paper 33-404 – Proposals to Enhance the Obligations of Advisors, Dealers, and Representatives towards their Clients

The Ontario Mortgage Investment Companies Association (“ONMICA”) thanks you for the opportunity to provide our comments in connection with the Canadian Securities Administrators’ (“CSA”) Consultation Paper 33-404 – *Proposals to Enhance the Obligations of Advisors, Dealers, and Representatives Towards Their Clients* (the “**Consultation Paper**”). The CSA are to be commended for their initiative in seeking comment on proposed regulatory action to improve the client-registrant relationship, and in announcing roundtable sessions to further explore the issues raised in the comments received.

ONMICA is an association of Mortgage Investment Corporations, Mortgage Funds, Mortgage Mutual Fund Trusts, and other Mortgage Investment Entities (MIEs) as well as registrants including exempt market dealers (“EMDs”) and mutual fund dealers registered with the Ontario Securities Commission who operate in the MIE space. There are currently 24 ONMICA members who collectively have over 260 employees and who collectively have approximately \$2.3 billion of gross assets under administration.

ONMICA’s purpose is to:

- Facilitate the exchange of information and ideas between members.
- Present a unified voice to regulators and other stakeholders to protect the specific interests of our industry.
- Set and uphold industry standards for ethics and professionalism.
- As an advocacy group for the MIE “community” dealing primarily with securities regulators (such as the Ontario Securities Commission) to further their understanding of the business of MIEs and ensuring the regulation of capital raising is fair, simple, and specific to our industry.
- To raise the profile and understanding of MIEs in the minds of both investors and capital raising industry participants.
- To assist the members of our organization with advice, problem solving, professional referrals, and investor referrals.

ONMICA membership criteria includes that the member firm’s primary source of income is derived from being or managing an MIE whose securities are distributed through a registered entity recognized by the Ontario Securities Commission, and who conducts business in an ethical and professional manner that positively reflects on the industry.

ONMICA through its member EMDs have attended, participated and provided feedback and comments during The Private Capital Markets Association of Canada (“PCMA”) consultation process in respect of its own Consultation Paper comment letter. ONMICA fully endorses and supports the PCMA comment letter. In addition, ONMICA offers general commentary relating to Ontario-based MIEs and their EMDs as follows:

MIE Captive Dealers

ONMICA’s member firms, and in fact MIEs across Canada, are for the most part comprised of captive dealers i.e. exempt market dealers that solely distribute securities of related or connected issuers with common mind and management. MIE securities are not generally distributed by large EMDs with multiple varieties of product on their shelf. The majority of MIEs are small and medium sized businesses who raise capital through captive dealers, who have thus far obtained registration on the basis of this business model. These captive dealers are transaction-based and do not seek to investigate let alone offer any other products to their investors. For various commercial reasons, these

MIEs do not see it practical or cost effective to access capital through the services of a traditional full service dealer. While the captive dealer model does inherently create a conflict of interest, such conflict is permitted under current securities legislation.

In response to Consultation Paper Question #14, it is respectfully submitted that there should not be any requirement for captive, proprietary MIE dealers to offer non-proprietary products. ONMICA is mindful of *CSA Staff Notice 31-343 – Conflicts of Interest in Distributing Securities of Related or Connected Issuers*, and its suggested ‘Acceptable Practices’, including the suggested practice of selling products other than those of the related or connected issuer (the rationale put forward being that ‘product diversification is an important factor to help reduce financial dependence of the dealer on the issuer.’) Imposing such a requirement on an MIE captive dealer does not reflect commercial reality and would unduly prejudice the selling of proprietary products and potentially force the connected or related MIE out of business. As noted by Matthew T. Burgoyne in “*Captive Dealers and Mortgage Investment Entities: Concerns and Safeguards*” (Private Capital Markets, Spring 2016, www.pcmacanada.com pp. 24-26), “Since the business focus and expertise of most MIEs and their Captive Dealers is very narrow and limited, compelling [one captive dealer] to sell securities of a third party issuer would be tantamount to forcing [that captive dealer’s related or connected issuer] to sell a competing product of another MIE.”

To be sure, there are helpful suggestions in *CSA Staff Notice 31-343* that can assist captive dealers to identify and respond to conflict of interests inherent in the captive dealer model. Nevertheless, in response to Consultation Paper Question #1, we concur with the PCMA that the proposed general framework does not provide sufficient guidance on how registrants should handle conflicts of interest that will withstand regulatory scrutiny during compliance review. We, like the PCMA, recommend the adoption of a Conflicts of Interest Disclosure Form that for MIE captive dealers will identify the specific types of material conflict of interests relevant to MIEs. We propose that this Conflicts of Interest Disclosure Form supplement the existing safeguards already in place including the relationship disclosure information mandated by Part 14 of *National Instrument 31-103* and the disclosure required by *National Instrument 33-105 Underwriting Conflicts* in the context MIEs distributing securities through an offering memorandum. In respect of the latter, ONMICA is also a proponent of requiring NI 33-105 disclosure in subscription agreements to the extent an offering memorandum is not made available to investors.

Proposed Regulatory Best Interest Standard

Ontario MIEs would be particularly affected by the proposed regulatory best interest standard since, in accordance with *CSA Staff Notice 31-323 – Guidance Relating to the Registration Obligations of Mortgage Investment Entities*, presuming certain criteria are met, MIEs in Ontario are not classified as ‘investment funds’ and are therefore not subject to the fiduciary duties imposed by statute and common law on investment fund managers and portfolio managers. The existing framework of exempt market dealer legislation, which MIEs in Ontario are subject to, does not impose a statutory fiduciary duty. A regulatory best interest standard will likely create confusion and will not be compatible with the captive dealer business model. An MIE captive dealer may be at risk of contravening the regulatory best interest standard if the MIE’s securities are not actually in a particular investor’s best interest. It may not have been the CSA’s intent to create confusion in the marketplace or smother the captive dealer industry however there is a substantial risk that this could happen if the proposed regulatory best interest standard is adopted. Moreover, it is not just EMD registrants who will be affected by the proposed regulatory best interest standard. The MIEs themselves, as issuers

that rely heavily on the captive dealer model, will also be affected. The proposed regulatory best interest standard might have a chilling effect on these small and medium sized MIEs who play an important role in the economy.

Unique Business Model of MIEs and Their Captive Dealers

The proposed targeted reforms involve a shift away from the current principle-based regulatory regime to a prescriptive one. As noted by the PCMA in its comment letter, “This shift away from principles-based regulation is particularly harmful to smaller registrants, such as EMDs, as a prescriptive regulatory regime ill-suited to their unique role in Canadian capital markets..... The targeted reforms, if implemented, must be done with awareness of the various business models and types of registrants involved. A ‘one-size fits all’ approach could have deleterious effects on registrants, investors and the capital markets.”

ONMICA concurs with the PCMA in that a ‘one-size fits all approach’ will have particularly negative effects on MIE captive dealers and on MIEs generally. MIEs are very different from other start-ups that operate in the exempt market. For instance, MIEs are income producing and therefore regularly distribute income. MIEs are often subject to other regulatory regimes mortgage brokerage and administration legislation. MIEs offer greater liquidity through redemption rights. Special considerations apply to make investments in MIEs less risky than those in other industries. To the extent the CSA proceeds with a shift to a more prescriptive regulatory regime, given the unique nature of the MIE industry in Ontario and small and medium sized MIEs important role in the local economy, ONMICA is committed to working with members of the CSA in identifying under what circumstances MIEs and their captive dealers can and should be exempt from certain requirements and what additional disclosure or other rules should specifically apply to MIEs and their captive dealers.

We thank you again for the opportunity to comment and would be pleased to answer any questions or meet with you (at the scheduled roundtables or otherwise) to discuss our comments and concerns.

Please do not hesitate to contact Chris Pridham CFP, AMP at tel: (905) 762-3388 or chris.pridham@scmic.ca or Diana Soloway (416) 922-1200 xt.203 diana@brookstreetmic.com

Yours very truly,

ONTARIO MORTGAGE INVESTMENT COMPANIES ASSOCIATION

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