

May 3, 2019

BY EMAIL

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

The Secretary
Ontario Securities Commission
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22nd Floor
Toronto, Ontario M5H 3S8
Email: comments@osc.gov.on.ca

M^e Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, rue du Square-Victoria, 4^e étage
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Montréal (Québec) H4Z 1G3
Email: consultation-en-cours@lautorite.qc.ca

Dear Sirs/Mesdames:

Re: **CSA Notice and Request for Comment – Proposed Amendments to National Instrument and Companion Policy 45-106 *Prospectus Exemptions* (NI 45-106) and National Instrument and Companion Policy 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (NI 31-103) (collectively, the “Proposed Amendments”)**

The Canadian Advocacy Council¹ for Canadian CFA Institute² Societies (the CAC) appreciates the opportunity to comment on the Proposed Amendments.

¹The CAC is an advocacy council for CFA Societies Canada, representing over 17,000 Canadian charterholders, of the 12 Member Societies across Canada. The council includes investment professionals across Canada who review regulatory, legislative, and standard setting developments affecting investors, investment professionals, and the capital markets in Canada. Visit www.cfacanada.org to access the advocacy work of the CAC.

² CFA Institute is a global, not-for-profit professional association of over 166,000 investment analysts, advisers, portfolio managers, and other investment professionals in 163 markets, of whom more than 159,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 152 member societies in 74 markets. For more information, visit www.cfainstitute.org.

As stated in our previous letter responding to the first publication of the Proposed Amendments in March 2018, we generally support the changes to the prospectus and registration exemptions for syndicated mortgages in light of the inherent risks associated with distributing such products to retail investors under the current regime. In our view, consistent with the objective of the Proposed Amendments, changes to the syndicated mortgage regime are important for investor protection. The Proposed Amendments would seek to further harmonize, to the extent possible, rules regarding the distribution of these products among all CSA jurisdictions, of which we are supportive.

We have outlined our comments on specific aspects of the Proposed Amendments below.

A. Annex C – Proposed Amendments to NI 45-106

Six-month Appraisal

We are generally supportive of the new requirements relating to the Offering Memorandum Exemption under section 2.9 of NI 45-106. Proposed subsection 2.9(19) will require an issuer to deliver to a purchaser an appraisal of the property subject to the syndicated mortgage that values the property as at a date that is within 6 months preceding the date that the appraisal is delivered. The CSA may wish to consider whether this requirement should be further expanded to require an appraisal within 6 months, or within a shorter timeframe if there has been an event that has a material adverse impact on the value of the property. Such a requirement would deal with unforeseen market events, such as the expropriation of surrounding properties, which may occur within the six month period.

Subsection 2.9(19.3) will outline the requirements for an issuer of a syndicated mortgage relying on an exemption set out in subsection (1), (2) or (2.1) to disclose any communication pertaining to a representation or an opinion as to the value of a property other than the fair market value. One such requirement is disclosure of the material factors or assumptions used to determine the value. We are of the view that such disclosure may not adequately address the risk of the assumptions used. In our prior comment letter, we had suggested that investors should also be made aware of the limitations of the valuation method used, in order to better understand the value that is disclosed. To achieve this goal, the disclosure could also be required to contain a description of the inherent risks and limitations of the assumptions relied upon.

Definition of Professional Association

The proposed definition of “professional association” found in section 1.1 of NI 45-106 includes a reference to the fact that a professional association “disciplines, suspends or expels its members if misconduct occurs”. This branch of the definition might be too narrow, as it is likely that such associations can only take action if they become aware of such misconduct. Consequently, it might be appropriate to refer instead to “having the power discipline, suspend or expel its members if it becomes aware that misconduct has occurred”.

Perceived Conflicts of Interest

Proposed subsection 2.9(19) states that: *“For the purposes of subsections (19.1) and (19.3), a qualified appraiser is independent of an issuer of a syndicated mortgage if there is no circumstance that, in the opinion of a reasonable person aware of all the relevant facts, could interfere with the qualified appraiser’s judgment regarding the preparation of an appraisal for a property.”* The CSA may wish to consider broadening the concept of a conflict of interest by

explicitly referring to circumstances which could reasonably be perceived to potentially interfere with the appraiser's judgement. We believe that the addition of "perceived or potential conflicts" would align more consistently with CSA expectations for registered firms under NI 31-103, where registrants must take reasonable steps to identify existing material conflicts of interest as well as material conflicts that the firm, in its reasonable opinion, would expect to arise, between itself and its clients, and then respond to those existing or potential conflicts. While the phrase "could" is used above instead of "would", as some firms are relatively inexperienced with CSA regulation, this nuance could be important, especially since Item 16 of Proposed Form 45-106F18 will require disclosure of potential conflicts of interest in other contexts.

Form 45-106F18

Item 2 – Raising of Funds

In section (1) of Item 2, the form will require disclosure of the period over which funds will be raised and the factors that determine when they will be raised. To the extent ongoing capital raises include progress draw mortgages or investments subject to cash calls, there should be a requirement to disclose committed capital amounts, as well as a prior cash call schedule. Such disclosure is consistent with suggested client reporting practices as set out in ASC Notice 33-705 *Exempt Market Dealer Sweep* ("ASC Notice 33-705") under the heading "Reporting to Clients".³

Item 3 – Other Risk Factors Specific to Syndicated Mortgages

We acknowledge that the list of potential risk factors detailed in the instructions is not exhaustive. However, when disclosing the risks and key assumptions in an offering memorandum, the CSA should consider adding the following as mandatory disclosure items for all syndicated mortgage offerings as well as disclosure of the risks related thereto and potential mitigation efforts:

- (a) interest rate capitalization ("cap rates") and any variations in cap rates;
- (b) the results of stress tests;
- (c) the maturity schedule for mortgages and any mortgage refinancing considerations;
- (d) operational risks including the servicing of the loans and expertise of the sponsor;
- (e) risks relating to progressive mortgage advances;
- (f) cost overruns, time delays, and a description of any cost consultants' reports;
- (g) level of tenant concentration;
- (h) rental growth rates;
- (i) credit spread-related risks;
- (j) liquidity risk; and
- (k) the existence of any shared co-lender or agency agreements and the risks thereof, including without limitation:
 - a. for loans with progressive advances, the risk of a lender not funding its share of such advance;
 - b. the remedies available to mitigate the risk of having a defaulting lender in the lending syndicate;

³ Alberta Securities Commission, ASC Notice 33-705 *Exempt Market Dealer Sweep* (May 10, 2017), online: <https://www.albertasecurities.com/-/media/ASC-Documents-part-1/Regulatory-Instruments/2018/10/5331553-EMD-Project-Staff-Notice-33-705.ashx>

- c. a description of the mechanism / approval thresholds for decisions by more than one lender (i.e. unanimous, simple majority, other);
- d. the process by which decisions are made to call an event of default under the loan, to realize on the security and/or re-structure the loan;
- e. the process by which the administrative agent can be replaced if it fails to comply with its obligations; and
- f. how and to whom a co-lender may assign an interest in its position.

Additional risk-related disclosure is needed, particularly in the case of syndicated mortgages because issuers may engage in high credit risk transactions such as unsecured lending and lending that involves high interest rate spreads over risk free bond rates.

Item 4 – Administration of the Mortgage

The CSA may wish to consider whether there should be an explicit requirement to state any connection or relationship under this section, in addition to the qualifications of the service provider. If any known conflicts of interest or operational risks exist, such as those that may relate to the servicing of the loan, they can be disclosed here in addition to the risk disclosure section under Item 3.

Item 6 – Property Subject to Disclosure

Item 6 of the proposed Form states that the offering memorandum must describe the details of the property subject to the mortgage. The CSA should consider whether there should also be explicit disclosure for any past material adjustments to valuations of the property and the reasons for such adjustments. These material adjustments may occur for various reasons, including changes in the valuation firm or changes to the underlying assumptions (i.e., cap rate/ discount rates) used.

Item 7 – Description of the Syndicated Mortgage

Item 7 of the proposed Form requires a detailed description of the syndicated mortgage. Factors not explicitly required but that are important to disclose to investors include information that may result in an impairment of the mortgage loan security, the debt service ratio, and material events that may impact the payments, such as insurance or prior natural disaster/ insurance claims, if applicable.

The Form will require disclosure of the loan-to-value (LTV) ratio of the property, calculated on an aggregate basis using the loan value of the syndicated mortgage and all other mortgages or encumbrances with priority over the syndicated mortgage and the appraised value of the property. Perhaps in the future, the CSA may wish to build on terms such as LTV in order to harmonize risk methodology for syndicated mortgages that will allow investors to better assess the viability of the mortgage.

Another key term that the offering memorandum should disclose is the duration of leases. By including such a term, the issuer will be able to better evaluate a lender's suitability and investment horizon by matching it to the duration or length of the lease.

Finally, an offering memorandum must be able to explain high credit risk in plain language to investors.

Item 8 – Appraisal

When undertaking an appraisal, the CSA should consider whether stress testing assumptions should be a required factor in an appraisal. We are of the opinion that stress testing assumptions provide valuable information to potential investors. In connection with a firm's KYP responsibility, ASC Notice 33-705 suggests that stress testing encompasses economic and financial variables that may have an impact on the issuer's performance (e.g., interest rate levels, unemployment rate, commodity prices and exchange rates).⁴

Item 19 – Registration Documentation

We recommend that the CSA should also mandate disclosure of the existence of any co-lender agreement.

B. Annex D – Proposed Amendments to NI 45-106CP

Proposed subsection 3.8(13) of the Companion Policy to NI 45-106 states that an independent qualified appraiser is required for syndicated mortgages. The examples provided in the guidance focus on the concept of ownership and employment considerations when determining the independence of an appraiser. We recommend that the CSA broaden this section to include guidance related to other ongoing relationships as well. For example, independence may be evaluated on whether additional services are provided by the valuation firm or services are provided by a related entity of the valuation firm that may jeopardize independence.

C. Additional Considerations

We understand that the different prospectus exemptions that will be available across the country are in part as a result of the differences in provincial mortgage regulation. We continue to encourage the CSA to seek harmonization of prospectus exemptions whenever possible to help ease the compliance burden on issuers and improve understanding of the exempt market amongst investors. We also support ongoing efforts to collaborate with other provincial regulators (such as FSRA), and focus should be given to reducing duplicative regulation as it relates to mortgage activities.

Concluding Remarks

We thank you for the opportunity to provide these comments. We would be happy to address any questions you may have and appreciate the time you are taking to consider our points of view. Please feel free to contact us at cac@cfacanada.org on this or any other issue in future.

(Signed) *The Canadian Advocacy Council for
Canadian CFA Institute Societies*

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⁴ Ibid.