

September 21, 2020

VIA EMAIL

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Dear Sirs/Mesdames:

Re: Proposed Regulation respecting the distribution of qualified syndicated mortgages (the “Proposed Regulation”)

The Canadian Advocacy Council of CFA Societies Canada¹ (the “CAC”) appreciates the opportunity to provide the following comments on the Proposed Regulation.

As noted in our prior comment letters to the CSA with respect to the amendments to National Instrument 45-106 *Prospectus Exemptions* and National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (“NI 31-103”), we generally support the broader changes being made to the prospectus and registration exemptions for syndicated mortgages as a result of the inherent risks associated with distributing such products to retail investors.

We were also supportive of the harmonization that the removal of the exemptions would achieve, being cognizant of the fact that mortgage brokerage legislation is not uniform in every jurisdiction. While we would generally prefer that the exemptions were the same in each province and territory, we do not object to the limited expansion of the prospectus exemption in Québec.

We understand that the Proposed Regulation will define a “qualified syndicated mortgage” and provide a prospectus exemption for the distribution of qualified

¹ The CAC is an advocacy council for CFA Societies Canada, representing the 12 CFA Institute Member Societies across Canada and over 18,000 Canadian CFA charterholders. 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.

CFA Institute is the global association of investment professionals that sets the standard for professional excellence and credentials. The organization is a champion of ethical behavior in investment markets and a respected source of knowledge in the global financial community. Our aim is to create an environment where investors’ interests come first, markets function at their best, and economies grow. There are more than 177,600 CFA charterholders worldwide in 165 markets. CFA Institute has nine offices worldwide and there are 160 local member societies. For more information, visit www.cfainstitute.org.

syndicated mortgages. Thus, the definition of a “qualified syndicated mortgage” is key, as it is intended to be limited to lower-risk mortgages primarily on residential properties. We agree that the scope of the definition should be limited.

We would also support a new exemption for syndicated mortgages sold to permitted clients, and a proposal to use the definition for “permitted client” currently found in NI 31-103 so that the waiver of suitability requirements applying to distributions of other securities could also apply to distributions of syndicated mortgages. Permitted clients are in our view sufficiently sophisticated to understand and appreciate the nuances and risks of various types of syndicated mortgages.

We believe the definition of a “qualified syndicated mortgage” should be the same throughout the CSA rules as well as in any specific rules governing mortgage brokerages in the province, and in other provinces and territories respecting their mortgage brokerage regulation. Currently, it is proposed that the definition in Québec will exclude mortgages with a loan-to-value ratio of greater than 80%, subject to certain calculation provisions. We believe that threshold is set too high.

The fair market value of a property can be volatile and depends on a variety of factors, including interest rates, the unemployment rate, and debt-to-income ratios. When a default occurs on a mortgage loan, the net proceeds from the sale of a mortgaged property will be reduced by a number of items, including unpaid realty taxes and the accrual of interest from the time of default to completion of property sale, as well as real estate broker sales commissions (plus taxes). The value may also be negatively impacted by deferred maintenance and by the loss in value resulting from the property being owned by a defaulting borrower (i.e. reputational stigma). The total loss in the value of the property as a result of these items can often amount to greater than a 20% loss, which could lead to a loss of principal for the lender, compounded further if the lender is subordinated to others.

Based on data available from the Teranet-National Bank National Composite House Price Index™, there was a decline of more than 5% in housing prices between 2009 and 2010 in a recessionary period².

In the current pandemic environment, setting the LTV threshold at 90% for syndicated mortgages is particularly risky, as prices could fall quickly leading to a loss of principal (and interest) on a mortgage loan with a 90% LTV ratio.

To provide an illustrative example:

Value of property before price decline:	\$100
Mortgage loan	: \$ 90
LTV (%)	: 90%

Value of property (after 5% decline) : \$ 95

² *House Price Index, Selected Composite 11*, online: House Price Index, Teranet and National Bank of Canada < <https://housepriceindex.ca> >

Unpaid realty taxes, realty broker commission and other costs (e.g. capex)	
	:(\$ 10)
Net sale proceeds:	: \$ 85
Amortized balance of mortgage loan (if amortization)	: \$ 88
Net loss to mortgagee	: \$ 3

It would therefore be more prudent to lower the LTV threshold in the definition of a “qualified syndicated mortgage” to 75%, which is typically the maximum level used by conventional (uninsured) mortgage lenders.

We understand that the sale of qualified syndicated mortgages remains subject to the dealer registration requirements because, in part, while supervision of the activities of mortgage brokers has been recently transferred to the AMF in May of 2020, the AMF’s regulatory framework for mortgage brokers has not yet been implemented. We agree that until such time as the framework is operational it would be premature to provide a registration exemption.

We understand that the different exemptions that will be available across the country are in part as a result of the differences in provincial securities and mortgage regulation. We support and commend ongoing efforts to collaborate with other provincial regulators. We continue to encourage the CSA and its various member jurisdictions’ other regulators to seek harmonization of prospectus and registration exemptions whenever possible, and reduce duplicative regulation to help ease the compliance burden on issuers and registrants and improve understanding of the syndicated mortgage market amongst investors and other market participants.

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 of
CFA Societies Canada*

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