

# Interpretation



**Effective Date:** May 12, 2020

**Identifier:** No. MB0040INT

## Mortgage Brokerage Disclosure and Suitability Assessments for Non-Qualified Syndicated Mortgage Investments (SMIs) – Responses to Market

### Purpose

This Interpretation Guidance<sup>1</sup> provides the Financial Services Regulatory Authority of Ontario’s (“FSRA’s”) interpretation of mortgage brokerages’ obligations under the *Mortgage Brokerages, Lenders and Administrators Act, 2006* (“MBLAA”). It addresses requirements for ensuring the protection of investors / lenders in a mortgage / mortgage investment during a significant market disruption, such as a declared emergency under the *Emergency Management and Civil Protection Act* (“Market Disruption”).

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<sup>1</sup> Interpretation Guidance is one of the four types of guidance that may be issued under FSRA’s [Guidance Framework](#). Interpretation Guidance sets out FSRA’s view of requirements under its legislative mandate (i.e. legislation, regulations and rules). Non-compliance can lead to enforcement or supervisory action. For more details, see <https://www.fsrao.ca/regulation/guidance/fsra-guidance-framework>.

Mortgage brokerages must consider the potential impacts of the Market Disruption in:

- disclosure of material risks to an investor / lender in a non-qualified syndicated mortgage investment (“SMI”);<sup>2</sup> and
- suitability assessment for a SMI investor / lender.

This Interpretation Guidance also identifies common deficiencies by mortgage brokerages in completing required disclosure forms, so that these may be avoided going forward.

## Scope

This Interpretation Guidance applies to licensed mortgage brokerages under the MBLAA dealing in SMIs.

## Rationale and Context

Mortgage brokers and agents are subject to Ontario Regulation 187/08, Mortgage Brokers and Agents: Standards of Practice, which, pursuant to section 3, requires a mortgage broker or agent not to do anything, or omit to do anything, that might reasonably be expected to result in the brokerage on whose behalf the mortgage broker or agent is authorized to deal in mortgages to contravene or fail to comply with a requirement established under the MBLAA.

Further, in supervising and regulating the mortgage broker and administrator sector, FSRA is required to administer and enforce the MBLAA and its regulations, including the Standards of Practice, in a manner that will achieve FSRA’s statutory objects<sup>3</sup>, in particular, to:

- contribute to public confidence in the regulated sectors;
- monitor and evaluate developments and trends in the regulated sectors;
- promote transparency and the disclosure of information in the regulated sectors;

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<sup>2</sup> While this Interpretation Guidance specifically clarifies the obligations of a mortgage brokerage to each investor / lender in a SMI during periods of Market Disruption, these obligations also apply to all other non-SMI transactions, as per sections 24, 25 and 31 of Ontario Regulation 188/08.

<sup>3</sup> See *Financial Services Regulatory Authority of Ontario Act, 2016*, s.3

- promote high standards of business conduct particularly with respect to financial services sectors; and
- protect the rights and interests of consumers particularly with respect to financial services sectors.

A Market Disruption, such as the current declared emergency due to the COVID-19 pandemic, can have an impact on a mortgage / mortgage investment and the underlying property. In turn, this can result in an obligation to disclose the Market Disruption and its impact to the lender / investor who is relying on the security of the property relating to the SMI. Moreover, this can also impact whether and to what extent the SMI remains within the risk tolerance of the investor / lender. This Interpretation Guidance is intended to provide FSRA's interpretation of mortgage brokers' and agents' obligations under the MBLAA, where Market Disruption constitutes a material risk related to the SMI.

## Interpretation

The MBLAA and its regulations govern mortgage brokering and administration activities in Ontario.

This Interpretation Guidance sets out FSRA's requirements for how a mortgage brokerage is required to meet certain requirements of Ontario Regulation 188/08, Mortgage Brokerages: Standards of Practice (the "Standards of Practice") under the MBLAA during a Market Disruption.

### Disclosure of Material Risks

Subsection 25(1) of the Standards of Practice requires a mortgage brokerage to disclose in writing to each investor / lender the material risks of a mortgage / mortgage investment, such as a SMI.

A risk is material if it is significant for an investor / lender to make a decision about a mortgage, or if its omission or misstatement would likely influence or change the decision of the investor / lender. Material risks include specific risks related to the SMI being considered, as well as general risks related to SMIs, as described in Form 3.1 – Suitability Assessment for Investor / Lender in a Non-qualified Syndicated Mortgage (Form 3.1).

Material risks include the potential risks associated with a Market Disruption on a mortgage / mortgage investment and the underlying property, such as, but not limited to:

- borrower's failure to make scheduled mortgage payments;
- default;
- amendments to the mortgage (e.g., mortgage maturity is extended);
- availability and cost of financing / refinancing;
- forbearance granted (e.g., payments are allowed to be deferred or capitalized);
- material delay in development of a project being funded by the mortgage;
- substantial reduction in sales / forecasted sales for the project funded by the mortgage;
- other encumbrances being registered on a mortgaged property (e.g., a tax lien);
- change in value of the underlying property and mortgage-based investment, such as a SMI (e.g., property values used in offering documents may no longer reflect rapidly changing market conditions);
- loan-to-value ratio (e.g., changing property valuations could result in higher-than-expected loan-to-value ratios); and
- change in the ability of an investor / lender to redeem prior to the maturity date of the mortgage investment.

Subsection 31.1(1)1 of the Standards of Practice requires that a mortgage brokerage provide each investor / lender the required disclosure information using a FSRA-approved form.

Subsection 31.1(1)16 of the Standards of Practice clarifies that the required disclosure information includes all information that a prudent investor / lender would consider material to a decision about whether to lend / invest money on the security of the property relating to the SMI.

A mortgage brokerage must use Form 3.2 – Disclosure Statement for Investor / Lender in a Non-Qualified Syndicated Mortgage (Form 3.2), complemented by the brokerage's own forms / documentation, as appropriate, for disclosure of material risks. Form 3.2.1 – Supplemental Disclosure for Retail Investors in High-risk Syndicated Mortgages (Form 3.2.1) may also be required if the same SMI is deemed to be high-risk. Both are FSRA-approved forms prescribed under subsection 54(1) of the MBLAA.

Disclosures would be considered inappropriate or misleading if assumptions, facts or information presented in the offering materials, Form 3.2 and Form 3.2.1 are:

- “known by the issuer” not to be true; or
- “unlikely” or “improbable” given material changes in market conditions.

## **Disclosure of a Property’s Estimated Market Value and Loan-to-Value (LTV) Ratio in a Market Disruption**

A mortgage brokerage is required under subsection 31.1(1)2 of the Standards of Practice to give each investor / lender an appraisal of the property relating to the SMI because the appraised value is critical to evaluating the risk associated with the SMI.

An appraisal with an effective date before the Market Disruption may be inaccurate, misleading or out of date, and may obscure the material risks associated with the SMI, which a mortgage brokerage is obliged to disclose to each investor / lender pursuant to sections 25(1) and 31.1 of the Standards of Practice. To comply with the obligation to disclose material risks, a mortgage brokerage must:

- consider whether the appraisal being supplied properly reflects the market / current value<sup>4</sup> of the property / project; a difference between these two values is material if it is significant for an investor / lender to make a decision about a mortgage, or if its omission or misstatement would likely influence or change the decision of the investor / lender;
- make the investor / lender aware of the risk of relying on an appraisal that was completed / dated prior to the occurrence of the Market Disruption, or that does not consider the potential impact of the Market Disruption on the property valuation; and
- where an appraisal contains limitation statements, bring such statements to the attention of the investor / lender.

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<sup>4</sup> The estimated market value of a property is also referred to as the ‘as is’ value in Form 3.2 and Form 3.2.1.

## Suitability Assessment

Section 24 and subsection 24.1(1)(d) of the Standards of Practice require a mortgage brokerage to complete a suitability assessment to analyze whether a SMI is suitable for an investor / lender. A mortgage brokerage is required to assess and consider the terms and risks of the SMI, as well as the unique circumstances and needs of the investor / lender — for example, the financial circumstances, investment needs and objectives, and risk tolerance.

When assessing suitability of the SMI for an investor / lender, a mortgage brokerage is required to take into account the potential impacts of a Market Disruption on the SMI, its probable future performance, and the unique circumstances of the investor / lender.

For example, a mortgage brokerage should consider:

- How has the Market Disruption impacted, and how will it impact, the stated appraised value of the property and the resulting LTV ratio?
- Has the Market Disruption increased the risks related to the SMI?
- Has the borrower’s ability to repay the loan changed?
- How does the Market Disruption affect the financial circumstances of the investor / lender?
- Is the SMI within the risk tolerance of the investor / lender and suitable for them, taking into account the most updated information, such as emerging risks and LTV ratio based on current property value in light of the Market Disruption?

As per subsection 24.1(1)(d) of the Standards of Practice, the mortgage brokerage is required to document its suitability assessment on Form 3.1 and provide a copy of it to each investor / lender.

## Common Deficiencies in Filings of SMI Disclosure Forms

Between June 8, 2019 and December 31, 2019, FSRA reviewed 269 Form 3.2s submitted by 33 mortgage brokerages in accordance with section 6.3 of FSRA’s Fee Rule 2019-001 Assessment and Fees (Fee Rule), representing approximately \$2.15 billion in SMIs.

The common deficiencies in the filings of Form 3.2 by mortgage brokerages included:

- failure to meet the five-day filing requirement;
- incorrect calculation of the LTV ratio;
- failure to complete information about the borrower / developer;
- inadequate disclosure of material risks; and
- failure to use the most recent version of the required form.

These common deficiencies must be addressed immediately by mortgage brokerages, as applicable, to ensure compliance with Subsection 31.1(1)1 of the Standards of Practice and FSRA's Fee Rule. FSRA will continue to conduct real-time supervision of SMIs and take appropriate action to monitor and enforce compliance with regulatory requirements.

## Supervision and Enforcement

Mortgage brokerages are required to comply with the MBLAA and its regulations, as interpreted in this Interpretation Guidance.

Failure to comply may result in enforcement or supervisory action including the imposition of licence conditions, suspension, revocation of licence, and enforcement proceedings seeking administrative monetary penalties.

## Effective Date and Future Review

This Interpretation Guidance becomes effective on May 12, 2020.

The latest possible date for FSRA to initiate a review of this Interpretation Guidance will be May 1, 2025.

## About FSRA

FSRA regulates the insurance, credit union, caisse populaire, mortgage brokerage, loan and trust, and pension administration sectors in Ontario in addition to providing deposit insurance for members of provincially-incorporated credit unions and caisses populaires.

FSRA's vision is financial safety, fairness and choice for Ontarians. Our mission is public service through dynamic, principles-based and outcomes-focused regulation.

## About this Guidance

This document is consistent with [FSRA's Guidance Approach](#). As Interpretation Guidance, it describes FSRA's view of requirements under its legislative mandate (i.e. legislation, regulations and rules) so that non-compliance can lead to enforcement or supervisory action.