

# Summary of Comments for Consultation on Supervision Approach for High-risk Syndicated Mortgages

FSRA Consultation on

## Supervision Approach for High-risk Syndicated Mortgages and Options for Burden Reduction re: Non-qualified Syndicated Mortgage Forms 3.0, 3.1 and 3.2

### Purpose of consultation

In its first-year priorities, FSRA has identified enhanced consumer protection of investors in high risk mortgages. To support this priority, FSRA consulted on a proposed [Supervision Approach for High-risk Syndicated Mortgages](#). The approach included a new [supplemental disclosure Form 3.2.1](#). The proposed supervision approach and supplemental disclosure Form 3.2.1 are in line with FSRA's priority to provide effective supervision of syndicated mortgages investments.

We sought feedback on the proposed supervision approach and the supplemental disclosure Form 3.2.1:

1. Does the supervision approach address the appropriate risks relating to syndicated mortgages for retail investors?
2. Does the new supplemental disclosure form clearly highlight that these are risky investments? Is the language in the new disclosure form easy to understand?

We received 32 submissions on the supervision approach and supplemental disclosure Form 3.2.1, during the time period of August 7, 2019 to September 6, 2019. The [submissions and comments](#) are available on FSRA's website.





This approach will be reconsidered if it is made redundant by the transfer of the regulation of high-risk syndicated mortgage transactions to the Ontario Securities Commission.

We will continue to focus on burden reduction, including other syndicated mortgage disclosure forms (link to forms 3.0, 3.1 and 3.2), to find opportunities to reduce regulatory burden on lower-risk syndicated mortgage transactions – this feedback is being reviewed as part of our burden reduction work. While not every stakeholder recommendation can be integrated into our approach at this time, we certainly value the commitment to reducing burden in this industry. It informs our decisions on an ongoing basis.

## What we heard

FSRA is appreciative of the significant effort that went into the comments it received on its approach to high-risk non-qualified syndicated mortgage investments (SMIs) and options for burden reduction for non-qualified SMI Forms 3.0, 3.1 and 3.2 (released July 2018).

FSRA would like to thank all commenters for the views expressed. FSRA has carefully considered all comments received.

Based on the feedback, FSRA is adopting the proposed supervision approach as proposed in August 2019. The following non-material changes have been made to Form 3.2.1:

1. The disclosure will state “A syndicated mortgage **is** a risky investment” versus “could be a risky investment”; and
2. Clarifications on when subordination introduces additional risk to a non-qualified SMI transaction

Many comments went beyond the scope of the consultation. FSRA will consider these comments in all its future policy work, and has shared relevant feedback with officials at the Ministry of Finance (MOF). Below is a synthesis of all the comments received, grouped by themes, and FSRA’s responses to those comments.

Feedback highlights include:

- “This is absolutely necessary and as a Mortgage Agent I personally welcome these changes”. Patricia Porretta, Rush Mortgages Inc.
- “This is certainly a step in the right direction”, Grant Fournier





- “I am somewhat concerned that investors will ultimately get numb to the mountain of papers that they are required to sign before each investment. So, not that this isn't a good idea, but some investors will be signing a book and this may get lost in the stack.” - Evan Cooperman, Foremost Financial
- "You can have the best disclosure forms in the world but the problem is that the investors do not read them. So, the forms do not in most cases have any value to the investing public. The investors rely on their agents in making the investment.” – David Franklin, Real Estate Lawyer
- “The form is straightforward, written clearly in plain language”, Pierre Pequegnat, DLC Sherlock Mortgages
- “The recent releases by FSRA seem quite appropriate to deal with clarity to the consumer/investor” Malcolm Eccles, CIR Mortgage Corp
- “MPC believes the approaches you propose are long overdue”. Paul Taylor, President, Mortgage Professional Canada
- “This is great to make sure agents are getting more verification for investors”, Laura Thompson, RMA
- “Thank you for your dedication and efforts in protecting our industry”, Reginald Robert Barnes, Barnes Mortgage Solutions *Inc.*
- “I reviewed the supervision report and the new Form 3.2.1 today. Fully support the actions and disclosures that have been undertaken”, Andrew Furino, Capital Mortgages Inc.

## **Our response**

Effective Nov 12, FSRA announces it is now issuing new guidance requiring all mortgage broker to advise consumers of the potential risk in this investment based upon clear factors as outlined in 3.2.1. Based upon industry and consumer consultation there was strong support for this approach. FSRA will continue to monitor SMI to ensure compliance while working with industry to reduce burdens.

## **List of Contributors**

The following stakeholders took the time to share their perspectives with FSRA.





Commenter	
1	2043919 Ontario Ltd O/A Best Choice Mortgage Services (Tom Jarvis)
2	Barnes Mortgage Solutions Inc. (Reginald Robert Barnes)
3	Broker (Alex)
4	Canadian Mortgages Inc. (Bryan Jaskolka)
5	Capital Mortgages Inc. (Andrew Furino)
6	CIR Mortgage Corp (Malcolm Eccles)
7	David Franklin





8	David Franklin
9	DLC Eagle Group (Derik Rehou)
10	DLC Sherlock Mortgages (Pierre Pequegnat)
11	Empirical Capital Corp. (David Strahl)
12	Firm Capital Corporation (Eli Dadouch / Victoria Granovski)
13	Fischer Group Inc. (Bruce Fischer)
14	Foremost Financial Corporation (Evan Cooperman)
15	Grant Fournier





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H Redlick Consulting (Harlan Redlick)

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Hillmount Capital Inc. (Diane Falcione)

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MarshallZehr Group Inc. (Murray Snedden)

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Mortgage Diligent Ltd. (Viaykumar Rana)

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Mortgage Intelligence (Michele HALL)

21

Mortgage Professionals Canada (J.P.  
Boutros on behalf of Paul Taylor)

22

MOS MortgageOne Solutions Ltd (Paul  
Mangion)

23

(Mike Marshall)





24	Newhaven Mortgage Corporation (Jason Vyner)
25	(Nick)
26	PMC Funding (Stephen Lidsky)
27	Privcomm Mortgages (Sergio Bogani)
28	RMA (Laura Thompson)
29	Rock Capital Investments Inc. (Dwight Trafford)
30	Rush Mortgages Inc (Patricia Porretta)
31	Vector Financial Services Limited (Mitchell Oelbaum)
32	Sharon VanderDuim





No.	Subject	Summarized Comment	Response
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1

Support for Approach

Many comments indicated general support for the goals of the targeted supervision approach, which includes supplemental disclosure to enhance protection for retail investors while not requiring supplemental disclosure for designated class investors.

FSRA has developed its supervision approach for high-risk SMIs to specifically help raise the awareness of retail investors about the risks of these projects.

FSRA is trying to balance the need to provide additional protections for retail investors / consumers while not imposing undue regulatory burden on investors from the designated class, who generally would not require the supplemental disclosure outlined in Form 3.2.1, as they have the resources, knowledge and experience to make informed investment decisions.





2

Concerns with Approach

Many comments also indicated concerns with / recommended enhancements to the supervision approach:

- disclosure alone about the risks of non-qualified SMIs is inadequate to protect retail investors
- high-risk SMIs are complex products and retail investors may not read the supplemental disclosure form or may not understand what they are investing in despite the disclosures; investors rely on their brokers in making the investment
- investor wealth may not be a valid indicator of investment knowledge or sophistication (e.g., some wealthy

FSRA has developed its new supervision approach, working within the current legislative and regulatory framework and using the tools it has available as a regulator.

FSRA believes the new supplemental disclosure, along with the introduction of real-time supervision of high-risk SMIs, and other brokerage requirements are tools that can protect consumers.

Real time supervision will allow FSRA to identify the highest risk SMI projects or brokerages dealing in those products and take immediate action to further



- the warning



Forms 3.2.1





No.	Subject	Summarized Comment	Response
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3.

Risk factors

It was commented that:

- disclosure of the appraisal value and loan-to-value (LTV) ratio does little, if anything, to protect investors in an SMI from risk of loss
- the loan-to-cost (LTC) value should be disclosed in addition to the LTV ratio as the LTC is an objective test that is less impacted by various assumptions unlike the LTV
- retail investors should obtain independent legal advice before completing the form and that it should be a requirement that is fulfilled on an annual basis

FSRA has created Form 3.2.1 to highlight three key risks for potential retail investors.

A high LTV (calculated as indicated on Form 3.2.1) is just one risk factor. FSRA expects that a mortgage broker will conduct a full assessment of the suitability of the non-qualified SMI for the investor based on a review of all key project information vis-à-vis the investor's specific circumstances, needs, risk tolerance, investment experience and knowledge before making a recommendation for investment to the investor.





4.

Investor / consumer education

It was suggested that campaigns in ethnic media could be used to warn investors about the risks of high-risk SMIs.

FSRA is committed to protecting the rights and interests of consumers, promoting public education and knowledge, and confidence in the regulated sectors.

FSRA will be establishing the Office of the Consumer, which will identify topics for potential consumer policy, outreach and education discussions that would enhance consumer protection/confidence when engaging in market activities that are delivered by the sectors that FSRA regulates. The commenter's recommendation will be considered as part of FSRA's



initiatives.



Forms 3.0, 3.1 and 3.2





No.	Subject	Summarized Comment	Response
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## 5. Regulatory burden

Many comments received expressed concern regarding the regulatory burden imposed by the SMI Forms 3.0, 3.1 and 3.2:

- the SMI forms should not be required for transactions with sophisticated / institutional / designated investors who do not need additional disclosures (e.g., when a brokerage is also the manager of a Mortgage Investment Corporation (MIC), it should not be necessary for the brokerage to provide completed SMI forms to itself as a MIC)
- completion of Form 3.0 for each transaction is

The SMI Forms 3.0, 3.1, and 3.2 are required under sections 24.1 (1) and 31.1 (1) of the O. Regulation 188/08 Mortgage Brokerages Standards of Practice under the Mortgage Brokerages, Lenders and Administrators Act, 2006 (MBLAA).

However, FSRA understands that completion of these SMI forms require brokerage resources and is considering options for reducing some of the burden imposed by the SMI forms on non-qualified SMI transactions with highly sophisticated investors. These options are being developed and will be presented to





Out of Scope of Consultations





No.	Subject	Summarized Comment	Response
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6.

Qualified / Non-qualified SMI Definitions

It was commented that the current definition of a non-qualified SMI could be changed:

- a non-qualified SMI should be defined as a private mortgage loan that satisfies any of the three risk factors on Form 3.2.1 versus the existing definition based on asset class
- residential construction mortgages with LTVs of 75% or less should be excluded from the high LTV flag, where the LTV is based on completed value less HST and estimated expenses to complete
- standard / simple syndicated commercial mortgage with LTVs of less than 75%

The definition of non-qualified SMI is outside of the scope of this consultation. Changes to the definition would require changes to the government's Ontario Regulation 188/08.

FSRA has shared all comments with officials at MOF as part of our ongoing policy or burden reduction initiatives. MOF, FSRA and the Ontario Securities Commission have been considering all comments received regarding the definition of a non-qualified SMI.






Participation in SMIs

It was commented that:

- retail investors should be prevented or restricted from participating in non-qualified SMIs / SMIs for the purpose of construction or development.
- SMIs should be outlawed completely

FSRA is working within the current regulatory framework, as set out by the government.

To address risks with this product FSRA is introducing the new supervision approach for high-risk SMIs that focuses on providing enhanced disclosure about an SMI to retail investors to help them make more informed investment decisions.

Under this new supervision approach, a brokerage must complete Form 3.2.1 with the investor and file a copy of the form for the first investor in the project with FSRA.  These requirements



Use of Registered Funds

It was commented that retail investors should not be allowed to use registered funds for SMIs intended to fund developer soft cost.

FSRA is working within the current legislative and regulatory framework.

FSRA agrees that it is generally not appropriate for investors to invest registered funds in SMIs. FSRA requires that mortgage brokers conduct suitability assessments based on the investor's situation, to ensure the products being recommended are appropriate.





Reports of Exempt  
Distribution

It was commented that complying with the requirement to file reports of exempt distribution for the distribution of SMIs is a significant financial and administrative cost.

The requirement to file a report of exempt distribution is a reporting requirement under the securities regime. It is not a requirement under the MBLAA.

Exempt Market  
Dealers

It was commented that retail investments in SMIs should only be permitted through an Exempt Market Dealer, and be restricted from the mortgage brokering industry.

FSRA has shared all comments with officials at MOF.





Licensing  
Requirements

Several commenters suggested that additional licensing and/or qualifications be required for mortgage brokers and agents that transact in non-qualified SMIs.

It was also commented that the majority of mortgage brokers and agents deal in residential mortgages, and that the complexity of commercial mortgages requires a certain level of knowledge and expertise.

FSRA is committed to exploring licensing qualifications for agents and brokers in 2020-21. One of FSRA's proposed strategic priorities 2020-21 is to support government policy direction on the MBLAA review. Recommendations in the MBLAA review report include reducing burden by establishing new classes of licensing and raising streamlining educational and professional standards for agents and brokers.







Lawyers versus brokerages

It was commented that some SMIs are not being distributed through a mortgage broker, instead the investors are relying solely on a lawyer and may not be fully informed of the risks of an SMI.

FSRA has shared all comments with officials at MOF.

Institutions versus brokerages

It was commented that SMIs should not be permitted by those working on commission. SMIs should be managed and guaranteed by a chartered bank, or entities with sufficient capital to cover potential claims.

FSRA has shared all comments with officials at MOF.





<p>Principal Broker</p>	<p>It was recommended to pose restrictions on which brokerage representatives can oversee SMIs (i.e., only principal brokers can sign the SMI forms).</p>	<p>FSRA expects that all activities of a brokerage, including SMIs, are ultimately supervised by the principal broker.</p>
<p>Insurance</p>	<p>It was commented that enhanced Errors and Omissions (E&amp;O) insurance be required for non-qualified SMI transactions. For example:</p> <ul style="list-style-type: none"><li>• minimum E&amp;O coverage of \$10 million if transacting in SMIs</li><li>• <i>sufficient</i> amount of E&amp;O, or</li><li>• individual broker / agent bonded in lieu of E&amp;O insurance</li></ul>	<p>The MBLAA requires that mortgage brokerages and mortgage administrators carry minimum E&amp;O insurance of \$500,000 per claim and \$1,000,000 aggregate per year, including extended coverage for fraud.</p> <p>FSRA has shared all comments with officials at MOF as part of our ongoing policy or burden reduction initiatives.</p>





## Appraisals

It was commented that:

- there were concerns with appraisal reports used for SMIs, citing potential conflicts of interest or reliability of appraisals
- appraisals should be peer reviewed by a fellow appraiser
- appraisals be provided within six months, or sooner if there is a negative material change.

FSRA has shared these comments with the Appraisal Institute of Canada.





Other

It was commented that SMIs should be subject to stress test calculations and that there should be fixed terms and principal amount protection for investors in an SMI.

FSRA has shared all comments with officials at MOF. SMIs are not guaranteed investments and may not be suitable for some investors. FSRA has created Form 3.2.1 to highlight three key risks to potential retail investors.

