CFA Societies Canada

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September 21, 2020

Financial Services Regulatory Authority of Ontario
5160 Yonge Street, 16th Floor
Toronto, Ontario
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Dear Sirs/Mesdames:

Re: Draft Supervision Approach for Non-Qualified Syndicated Mortgage Investments with Permitted Clients and Legacy Non-Qualified Syndicated Mortgage Investments (the "Draft Approach Guidance")

The Canadian Advocacy Council of CFA Societies Canada[1] (the "CAC") appreciates the opportunity to provide the following comments on the Draft Approach Guidance.

We understand that the Draft Approach Guidance sets out FSRA's supervision practices for mortgage brokers and administrators transacting in certain types of syndicated mortgages, and primarily non-qualified syndicated mortgage investment transactions with investors/lenders that qualify as permitted clients. The Draft Approach Guidance also covers its oversight of those that transact with borrowers in non-qualified syndicated mortgage investment transactions, regardless of the identity of the investor/lender.

We support FSRA's principles-based approach, and how it intends to utilize data it gathers to target supervision of higher-risk brokerages and administrators.

It is important to harmonize the definition of "permitted client" that is proposed to be included in Ontario Regulation 188/08 – *Mortgage Brokerages; Standards of Practice* with the current definition of a "permitted client" in National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*, as well as monitor that instrument for future changes, to help prevent marketplace confusion.

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 believe the definition of a "qualified syndicated mortgage" should be the same in the FSRA rules and

[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.

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throughout the various CSA local rules relating to prospectus and registration exemptions. One of the risk profile factors noted in the Draft Approach Guidance is a high loan-to-value ratio, expressed as an LTV of 90% or higher (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 10% 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 period[2].

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
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” and FSRA’s risk profiling to 75%, which is typically the

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

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maximum level used by conventional (uninsured) mortgage lenders. While some other provinces, including Quebec, Alberta and New Brunswick, have suggested that the LTV ratio in the definition be set at 80%, closer to our recommended target, this would still be 5% off what we believe to be the mortgage lender standard.

As set out in the Draft Approach Guidance, FSRA intends to focus its compliance reviews on the due diligence conducted by a mortgage brokerage to ensure that an investor/lender is in fact a permitted client, which is expected to include documentation collected and the signed confirmation from the investor/lender. We believe a review of conflicts of interests should also be a focus of compliance reviews, particularly risk-enhancing conflicts such as non-arm's length borrower relationships to the administrator and similar relationships amongst those involved in the mortgage origination. Conflicts should be reviewed for not only direct ownership relationships, but on factors such as whether additional services are provided by a related entity of the mortgage brokerage or administrator. A close examination of the property appraisals and the valuators for non-arm's length indicia would also be a helpful investor/lender protection measure.

It is equally important to continually educate mortgage brokerages on these requirements and ensure that licensing courses and/or continuing professional development requirements for licensees cover these topics, and that meaningful penalties or other terms and conditions exist and are applied for non-compliance.

We also support ongoing efforts to collaborate with other provincial regulators, and focus should be given to reducing duplicative regulation and to improve understanding amongst investors and other market participants as it relates to mortgage activities. It would also be helpful for FSRA to provide clarity on which of its rules would be applicable to multi-jurisdictional transactions, such as when a mortgage is syndicated to investors located in Ontario on a property located in another Canadian jurisdiction.

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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