February 21, 2013

British Columbia Securities Commission
PO Box 10142, 701 West Georgia Street
Vancouver, BC V7Y 1L2
Attention: Mark Wang

Financial and Corporate Sector Policy Branch
Ministry of Finance
PO Box 9418 Stn Prov Govt
Victoria, BC V8W 9V1

Re: Proposed Registration of Mortgage Syndicators as Exempt Dealers: BC Notice 2012/01

Thank you for providing the Mortgage Brokers Association of BC (MBABC) with an opportunity to comment on BC Notice 2013/01 which proposes to revoke:

- BC Instrument 32-513 *Registration Exemption for Trades in Connection with Certain Prospectus-Exempt Distributions* (the NW exemption) and
- BC Instrument 32-517 *Exemption from Dealer Registration Requirement for Trades in Securities of Mortgage Investment Entities* (the MIE exemption).

I write here to address this issue only in regards to mortgage syndicators, and will address how the revocation of registration exemptions for the mortgage investment entities would affect mortgage investment corporations in a separate letter. However, since some of the issues also touch on the *Mortgage Brokers Act* (the MBA), and how that legislation might be further strengthened, I am also addressing this letter to the Financial and Corporate Sector Policy Branch of the Ministry of Finance.

By way of background, the MBABC is a provincial association of mortgage brokers and lenders, which was established over 20 years ago. We recently held town hall meetings throughout the province to consult with the mortgage industry, including non-members, on the issues presented in BC Notice 2012/01. The industry spoke out with a relatively uniform message, which I shall articulate below.

The mortgage industry is of the view that the regulation of all mortgage syndications in British Columbia is more appropriate under the MBA than under the *Securities Act* for the following reasons:

- A syndicated mortgage is more like an interest in land than a security and fits better within the requirements of MBA regulation than under *Securities Act* regulation;

- It would provide a simpler, less confusing, more uniform regulatory regime for mortgage syndications, as some syndicated mortgages are already regulated under the MBA, while others are regulated under the *Securities Act*;

- The MBA already provides comprehensive regulation of mortgage syndications and licensing of syndicators, which can be strengthened even further with a legislative overhaul of the MBA, which is now underway;

- It furthers the goals of the Agreement on Internal Trade (AIT) by harmonizing BC requirements for mortgage syndicators with those of Ontario, which is the largest syndicated mortgage economy in Canada; and

- It would ensure that there is no impact on the availability of mortgage capital to mortgage borrowers, as the significant burden of requiring mortgage syndicators to obtain dealer registration will remove a portion of syndicated mortgage funds from the economy.

I can expand on these points in a more detailed discussion which is set out below.

<u>Is a Syndicated Mortgage a Security or an Interest in Land?</u>

We are of the view that the question about whether the regulation of mortgage lenders, including syndicated mortgage lenders, belongs under the securities or the mortgage broker/lender regime hinges on whether a mortgage is considered to be a security or an interest in land. From a historical perspective, the law of mortgages developed exclusively under the system of real property law. The practice of securing money obligations against title to land dates back to Anglo Saxon times, when the entire property title was transferred to the lender and only reverted back to the borrower after the final payment of the loan was made. In *Bank of Montreal v. Orr* (1986), 4 B.C.L.R. (2d) 1 at 7 (C.A.), the BC Court of Appeal explained that a mortgage was two things: "(a) a contract on the part of the mortgagor for the payment of a debt to the mortgagee; and (b) a disposition of an estate or interest of the mortgagor to the mortgagee as security for the repayment of the debt."

Interests in land are fundamentally different in nature than securities. Real estate is tangible, immovable, non-homogeneous and indestructible. No two properties are identical, and each property has a unique value based on its scarcity, location, zoning bylaws, improvements, and certain economic factors such as supply and demand. A mortgage is not like a fund or a pool of investments, which may have no specific or tangible security to protect investors – a mortgage is a single loan secured against a specific property title with an ascertainable value. Mortgage brokers who arrange mortgage loans provide lenders with due diligence so that they can ascertain that lenders have equity in the property to cover the mortgage debt in the event

of borrower default. A mortgage is therefore a reasonably safe, low risk investment for a lender or a group of syndicated lenders.

The characteristics of securities are quite different from mortgages. Securities are stocks, debentures, derivatives and bonds – things considered to be liquid, uniform if in the same class, created by an issuer, often risk rated by a rating agency, sometimes sold on a stock exchange with complex trading rules, and lacking any tangible security to protect the investor. These characteristics create a riskier investment, and one can clearly see that their trade would require more stringent regulatory oversight to protect investors from unnecessary risk. The relative safety of mortgage security should be a factor to consider when determining the appropriate regulatory regime for industry members who arrange syndicated mortgages.

Mortgage brokers and lenders usually know very little about stocks and bonds, and likewise, fund managers and investment dealers may understand little about land issues and mortgages. Mortgage professionals and security dealers clearly operate using different terminology, concepts and valuation systems and therefore require fundamentally different training and oversight rules.

Mortgages are clearly an interest in land. This, we believe to also be the common understanding of the public, and in particular mortgage borrowers and lenders. In addition, the concept of the mortgage as an interest in land and loan is already embraced in the *Securities Act,* as section 8.12 of NI 31-103 provides a dealer registration exemption for mortgage brokers registered under the MBA dealing in mortgages (except syndicated mortgages).

Syndicated mortgages are not a complicated concept. Subsection (1) of 8.12 defines a syndicated mortgage to mean "a mortgage in which two or more persons or companies participate directly or indirectly, as lenders in the debt obligation that is secured by the mortgage". The shared nature of the mortgage loan by more than one lender does not in any way alter the qualities of syndicated mortgages which make them more like an interest in land than a security. **There simply does not appear to be any rationale for carving syndicated mortgages out of the MBA regime and placing them under the Securities Act, other than perhaps syndicated mortgages might be considered to be more complex than single lender mortgages. However, this proposition can easily be challenged.** Many a mortgage broker, particularly ones who arrange commercial mortgages, inter alia mortgages, development financing and draw mortgages with a single lender can attest that it is the nature of the transaction and not the number of lenders sharing in the loan that will add to the complexity of a mortgage deal.

<u>Hybrid Regulation of Syndicated Mortgages under the MBA and the *Securties Act*</u>

With the implementation of the BCSC proposal, there would continue to be a hybrid system of regulation over syndicated mortgages under the MBA and the *Securities Act*. The MBA would have jurisdiction over qualified syndicated mortgages and other syndicated mortgages which are arranged by a person without a "business trigger". The *Securities Act* would have

governance over all mortgage syndications, which are not a qualified syndicated mortgage or arranged by a broker who, as an issuer, is in the business of syndicated mortgages.

Qualified syndicated mortgages are a subset of syndicated mortgages created by statute and are generally exempt from dealer registration and prospectus requirements of the *Securities Act* (see *BC Instrument 45-501* and section 18 of the *Regulations* to MBA) and are regulated under the MBA. Qualified syndicated mortgages are defined to have the following characteristics:

> (a) the syndicated mortgage is not contained in or secured by a bond, debenture or similar obligation or in a trust deed or other instrument to secure bonds or debentures or similar obligations,
>
> (b) the syndicated mortgage is sold through a mortgage broker,
>
> (c) the syndicated mortgage secures a debt obligation on property used solely for residential purposes and containing no more than four residential dwelling units,
>
> (d) the syndicated mortgage does not secure a debt obligation incurred for the construction or development of property,
>
> (e) at the time of issue, the amount of the debt secured by the syndicated mortgage, together with all other debt secured by mortgages on the property that have priority over, or the same priority as, the syndicated mortgage, does not exceed 90 percent of the fair market value of the property, excluding any value that may be attributed to proposed or pending development on the property,
>
> (f) the syndicated mortgage is limited to one identified debt obligation,
>
> (g) the rate of interest payable under the syndicated mortgage is equal to the rate of interest payable under the identified debt obligation,
>
> (h) any amount charged for the administration of the syndicated mortgage is disclosed to the purchaser, and
>
> (i) the term of the syndicated mortgage is not different from the term of the identified debt obligation.

The rationale for identifying certain characteristics of a mortgage, more specifically a qualified syndicated mortgage, and determining that the regulation of the broker or dealer involved in arranging the mortgage ought to be under the MBA and not the *Securities Act* is not apparent. A mortgage is simply an instrument for securing a debt. If the debt obligation is different from what is set out in the mortgage, then the transaction is something completely different from a mortgage and perhaps the concept of a mortgage and a security is now being muddled in the definition of a qualified syndicated mortgage. The factors listed above under (g) and (i) are

therefore irrelevant as they do not represent the characteristics of any mortgage. Likewise legal mortgages are registered against a property title in a Form B land instrument, and other instruments securing a debt, such as debentures and bonds (listed in factor a) clearly identify securities and not mortgages and do not need to be part of definition describing what a syndicated mortgage is not.

As discussed above, mortgages for commercial transactions (factor c) and development construction (factor d) do not transform the nature of a mortgage transaction and turn into more of a security than an interest in land – they are simply factors which address the potential complexity of the transaction. Factor (e) speaks to the risk of the mortgage, and similarly a higher risk mortgage with a higher loan to value ratio does not transform the mortgage transaction into more of a security than a mortgage. Factors (c) to (e) are therefore not an appropriate rationale for determining that regulation under the *Securities Act* is more appropriate than the MBA for these more complex transactions.

I note that factor (b) clearly demonstrates that Securities legislation really does not understand the mortgage industry, as syndicated mortgages are not "sold" to investors – rather syndicated mortgages are brokered and lenders are organized into mortgagees.

The distinction between qualified syndicated mortgages and syndicated mortgages appears to recognize that it is appropriate for certain mortgages to be considered as interests in land and therefore regulated under the MBA. However, the distinction appears to contain arbitrary and irrelevant factors which speak to complexity and risk but not to whether the nature of the transaction is fundamentally transformed from a land based loan to a security transaction. We therefore propose that the distinction between qualified syndicated mortgages and syndicated mortgages should be eliminated from both the *Securities Act* and the MBA.

With the implementation of NI 31-103, the trade trigger will be replaced by a business trigger, so that if an issuer "sells" a syndicated mortgage, there must be an assessment of whether the specific activity engaged in by the issuer is a "business". If the issuer is in the business of raising funds from syndicated mortgages, then dealer registration under the *Securities Act* would be required. One of the factors which could help determine whether the syndication activity is a business would likely be the repetition or frequency of the activity. Many mortgage brokers arrange syndicated mortgages on an infrequent basis simply as part of their mortgage arranging activities which are regulated under the MBA. Presumably, mortgage brokers who broker the odd syndicated mortgage would not be in the business of raising funds through syndicated motgages and would not require dealer registration.

However, there are other factors which will assist in determining whether syndication activity fits the criteria of "in the business", such as the amount of remuneration paid to the syndicator by the investor. In most if not all private mortgages arranged in British Columbia, including syndicated mortgages, lenders do not pay any kind of capital raising fee or commission to the mortgage broker. Rather, mortgage origination fees are paid by borrowers – these fees are clearly mortgage broker fees, which would appear to be governed by rules under the MBA and

not the *Securities Act*. If no mortgage brokers are paid capital raising fees or commissions by syndicated lenders, can it be concluded that they are in the business of raising capital from mortgage syndications? If the ultimate purpose of any business is to generate income, it might easily be concluded that there is no business purpose if there is no income earned from a capital raising activity. Perhaps all private mortgage arranging, including syndicated mortgage arranging will not trigger the dealer registration requirement if they earn no capital raising fees and therefore have no capital raising business.

Despite the murkiness of the business trigger, NI 31-103 will continue to ensure that certain kinds of syndicated mortgages will be regulated under the MBA – qualified syndicated mortgages and syndicated mortgages arranged without a business trigger. This hybrid regulation of brokers arranging syndicated mortgages will create confusion and uncertainty not only for the industry but also for the public who must determine which regulatory authority will regulate a mortgage broker if they have a complaint or an enquiry about the rules relating to mortgage syndication. The public would be better protected by a single regulator for syndicated mortgages. The mortgage broker regulator under the MBA would provide the most appropriate oversight for brokers arranging mortgage syndications. I can explain why below.

Appropriate Elements of Regulation for Syndicated Mortgages under the MBA

The MBA creates a licensing system for mortgage brokers who arrange mortgages between lenders and borrowers. Mortgage brokers are required under section 17.1 of the MBA to provide any private mortgage lender, who does not qualify as a sophisticated lender, with a lender disclosure statement in Form 9 prior to mortgage funding. Regardless of any applicable agreement, the lender is not obligated to advance funds under the transaction unless the mortgage broker has provided the Form 9 and all applicable attachments to the lender. In addition, a new Form 9, containing updated information, must be provided to the lender. If there are multiple lenders sharing in the mortgage loan, separate Form 9's must be provided to each lender.

The pertinent investment information applicable for each lender must be included in the separate Form 9, which includes the following:

- If the mortgage being arranged for an investor is to refinance a current mortgage which is or has recently been in arrears or is to acquire a current mortgage which is or has recently been in arrears, then these defaults, provided that the mortgage broker is aware of them, must be disclosed to the lender.

- The method of securing the lender's interest against title – which will be either directly by naming them as a mortgagee in the Form B mortgage or by way of a trust agreement, in which the lender is identified in a trust agreement as a beneficial lender.

- The percentage interest that the lender has in the mortgage and the number of other parties who have an interest in the mortgage investment.

- Whether the lender's funds will be held in trust pending completion of the mortgage transaction, and the name of any party who will be holding the funds in trust.

- Whether the mortgage will be administered by someone on behalf of the lender. In addition, any fees associated with the administration of the mortgage must be stated or alternatively, a copy of the Administration Agreement which describes the fees must be attached to the Form 9.

- The mortgage broker must indicate whether or not the lender's investment will be registered as an inter alia mortgage against more than one property title.

- Property information must be disclosed, including the legal and the municipal address of the property; the type of property – whether it is residential, commercial or multi-family, and whether it has an existing building or is vacant land.

- Mortgage details must be disclosed, including:

    - the amount of the mortgage investment;

    - the amount of principal which will be stated in paragraph 5 of the registered Form B Mortgage instrument;

    - the maximum indebtedness of the mortgage;

    - the interest rate expressed as a percentage, if the interest rate is fixed, or if the interest rate is variable, an explanation of how the interest rate will be calculated;

    - the rate at which the interest will be compounded, or the compounding period;

    - the payment frequency;

    - whether the payments to be made under the mortgage will be interest only;

    - the payment amount;

    - the term;

- the amortization period;
- the date the mortgage investment will mature;
- the projected balance of the mortgage at maturity date, assuming that there are no arrears owing by the borrower under the mortgage;
- the due date of the first payment to be made by the borrower;
- whether the mortgage secures a running account, and the details of any running account; and
- the rank of the mortgage investment (i.e. first, second, etc.).

- Whether there are any financial encumbrances which rank in priority to the mortgage investment after completion of the mortgage transaction;
- The amount owing or the maximum indebtedness (which ever figure is higher) of all encumbrances which rank in priority to the mortgage investment;
- Whether any mortgage ranking in priority is in default;
- The name of lender or charge holder on any financial encumbrance ranking in priority;
- The annual property taxes;
- Whether there are any property taxes in arrears and the amount of any arrears;
- If the Form 9 Disclosure relates to construction financing, confirmation that the zoning on property to be developed is appropriate for the proposed use of the property; and
- The value of the property, and the basis for the property valuation. If valuation for the property is based on an appraisal, whether the valuation is for a current or projected value.

In addition, the following documents must be attached to the Form 9 Disclosure:

- A copy of any existing mortgage on the property;
- A copy of any appraisal;
- A copy of any purchase and sale contract entered into by the borrower for the purchase of the property;

- Any documentary evidence respecting the borrower's ability to meet the mortgage payments, such as credit bureau report or a letter from an employer disclosing the borrower's earnings;
- A copy of the borrower's application for a mortgage;
- If the mortgage is a new mortgage, documentary evidence of any down payment made by the borrower for the purchase of the property;
- A copy of any agreement that the lender may be asked to enter into with the mortgage broker or other administrator. This will include an administration agreement for a party to administer the mortgage on the lender's behalf or a trust agreement if the mortgage is registered against title in the name of a trustee; and
- A copy of the Cost of Credit Disclosure provided to the borrower.

Mortgage brokers are also required to provide lenders with all other information an investor of ordinary prudence would consider being material to a decision whether to lend money on the security of the property, so that they can make an informed decision before they commit to invest. This information might include the following:

- If the mortgage is for a construction or development project:
  - A detailed description of the project;
  - A schedule of the funds that have been advanced or are to be advanced to the borrower;
  - The identity of any person who will monitor the disbursements of fund to the borrower and the use of those funds by the borrower; and
  - Environmental considerations affecting the value of the property.
- If the property is rental property:
  - Details of leasing arrangements and vacancy status; and
  - Environmental considerations affecting the value of the property.

As you can ascertain from the foregoing, the regulatory regime under the MBA is comprehensive and clearly geared for mortgage lenders, including syndicated mortgage lenders. In addition, mortgage brokers who arrange syndicated mortgages are registered under the MBA, and must qualify for mortgage broker registration by taking mortgage specific qualification and relicensing courses, and pass a suitability review every two years, including a

criminal record check. Mortgage brokers are also required to comply with detailed trust accounting and reporting requirements under the MBA if they handle trust funds.

However, the MBA could be further enhanced by requiring mortgage brokers to ensure that non-sophisticated lenders are getting appropriate product suitability advice from the broker. The broker should be assessing clients, including non-sophisticated syndicated mortgage lenders to determine their:

- Risk tolerance and required rate of return;
- Need for steady monthly cash flow as prerequisite for participating in a mortgage investment; and
- Net worth, experience in investing, income, goals and objectives.

In Ontario, product suitability advice and disclosure of material risk is required under sections 24 and 25 of the *Mortgage Brokerages: Standards of Practice.*

We propose that the MBA be amended to provide for similar product suitability assessments for non-sophisticated lenders and risk disclosure obligations. It would then provide a comprehensive, relevant and complete system of oversight for mortgage brokers who arrange syndicated mortgages.

This system provides the best protection for lenders as it is specifically designed to provide mortgage lender disclosure and other protections for syndicated mortgage lenders. In contrast, the *Securities Act* provides a generic exempt market dealer regime for various kinds of securities, with no program specifically geared for land interests such as syndicated mortgages. This regime is the round hole within which syndicated mortgages, being a square peg, do not fit. There is no need to add an extra regulatory burden to the syndicated mortgage industry, particularly when there is absolutely no corresponding benefit.

Harmonization of Syndicated Mortgage Regulation with Ontario

In Ontario, the legislature in its wisdom and after hearing the concerns of the mortgage industry decided to regulate mortgage brokers who arrange syndicated mortgages under the *Mortgage Brokerages, Lenders and Administrators Act,* which was brought into force in 2006. Section 35(4) of the Ontario *Securities Act*, therefore exempts mortgage brokers licensed under *Mortgage Brokerages, Lenders and Administrators Act* from dealer registration requirements.

Both British Columbia and Ontario are parties to the AIT. The AIT has been established to prevent governments from creating trade and labour mobility barriers. Some of the governing principles of the AIT are to:

- Establish equal treatment for all Canadian persons, goods, services and investments.

- Prohibit measures that restrict the movement of persons, goods, services or investments across provincial or territorial boundaries.

- Ensure that provincial government policies and practices do not create obstacles to trade.

- Provide the basis for eliminating trade barriers caused by differences in standards and regulations across Canada.

Ontario represents the largest syndicated mortgage economy in Canada. If Ontario, after engaging the public in a rigorous legislative review process, has determined that it is appropriate for mortgage syndicators to be regulated as mortgage brokers under mortgage brokerage legislation and not securities legislation, then British Columbia must following suit. To do otherwise would be contrary to the AIT and would create labour mobility, investment and trade barriers between Ontario and BC that are discriminatory and cannot be justified.

Maintaining Current Levels Mortgage Capital in the Market for Borrowers

The BCSC Memorandum, dated October 11, 2012 which analyzes the impact of capital raising requirements on the mortgage investment industry concluded that only $1.8 million dollars would be taken out the available pool of available mortgage funds in the overall British Columbia economy. This analysis is completely flawed as it appears to rely on records of commissions earned from capital raising, and as I have already explained, syndicated mortgage investors do not pay any commission to brokers for arranging loans. This estimate grossly under values the level of mortgage capital which would be affected by the proposed new regulation. Certainly the actual dollar amount in issue is, at least, in the several hundred million dollar range.

The MBABC presented a survey to industry members to obtain some data about mortgage syndication activity in BC (attached). The survey indicates that many hundreds of millions of dollars are arranged into syndicated mortgages every year. 66% of syndicators reported that they would not continue syndication activity if required to register as an exempt marker dealer. This is due to the significant registration and ongoing compliance costs. Also, syndicated mortgages are commonly placed as seconds or thirds behind a larger first mortgage to provide sufficient mortgage principal for the borrower. The loss of syndicated mortgages funds will therefore have an impact on the mortgage borrower which is probably impossible to quantify and exponentially greater than the value of the syndicated mortgages lost from the economy. The impact to the economy of implementing the BCSC proposal will therefore include:

- Significant increases in costs passed on to borrowers though higher interest rates and fees;

- The loss of syndicated mortgage lenders from the marketplace, which will make it more challenging for borrowers to find available mortgage capital;

- Some borrowers will be unable to complete a mortgage transaction without the support of an added second or third mortgage;

- Loss of employment from mortgage industry members and support staff who would no longer be arranging and administrating syndicated mortgages – also the loss of construction related employment from developers and builders who would not be able to finance developments;

- Loss of investment opportunities for lenders who may find other places to put their funds; and

- Higher borrowing costs and less access to mortgage capital will lead to an increase in foreclosure rates and borrower defaults.

Recommendations:

For the reasons stated above, the MBABC urges that the BCSC not implement the proposal contained in BC Notice 2013/01 in relation to syndicated mortgages. The MBABC further proposes that:

- The definition of qualified syndicated mortgage be eliminated from both the *Securities Act* and the MBA;

- All syndicated mortgages be regulated under the MBA; and

- The MBA be amended to require mortgage brokers to provide product suitability advice and disclosure of material risks to syndicated lenders.

If you wish to discuss any of these matters further, please feel free to contact me.

Yours truly,

Samantha Gale
CEO, MBABC