



Via Email

June 6, 2018

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Autorité des marchés financiers
British Columbia Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Financial and Consumer Services Commission (New Brunswick)
Manitoba Securities Commission
Nova Scotia Securities Commission
Nunavut Securities Office
Office of the Superintendent of Securities, Newfoundland and Labrador
Office of the Superintendent of Securities, Northwest Territories
Office of the Yukon Superintendent of Securities
Ontario Securities Commission
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island

Dear Sirs/Mesdames:

Re: Proposed Amendments to National Instrument 45-106 Prospectus Exemptions and National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations relating to Syndicated Mortgages and Proposed Changes to Companion Policy 45-106CP Prospectus Exemptions (“Proposed Amendments”)

The purpose of this letter is to provide comments on the Proposed Amendments. Specifically, we will comment on:

1. The removal of the prospectus and registration exemptions for the distribution of syndicated mortgages; and
2. The introduction of additional requirements when relying on the OM exemption to distribute syndicated mortgages; and
3. The amendment to the private issuer prospectus exemption so that it is not available for the distribution of syndicated mortgages.



When considering the Proposed Amendments, we are viewing them through the CSA's lens which expresses the dual objectives of:

1. Providing additional investor protections related to syndicated mortgages; and
2. Increasing harmonization regarding the regulatory framework for syndicated mortgages across all CSA jurisdictions.

Further, regarding syndicated mortgages, the CSA has stated that "there has been a significant increase in the offering of syndicated mortgages in connection with **real estate developments** in certain jurisdictions."

The CSA then outlines the specific risks associated with mortgages related to real estate developments, namely that, "these offerings potentially raise investor protection concerns, particularly when sold to retail investors, because they may:

- be used to raise seed financing for real estate developments, such as the costs of initial design proposals and start-up expenses;
- be sold based on projected values of a completed development;
- not be fully secured by a charge against real property, since the amount of the loan may significantly exceed the current fair value of the land;
- be subordinate to future financings, such as construction financing, which may be substantial and effectively render the investment more similar in risk to an equity investment rather than a fixed income investment;
- be offered by issuers with no source of income, rendering the payment of ongoing interest dependent on future financing or reserves from the principal advanced; and
- be subject to the risk of delay and increased costs inherent to real estate development."

The prevailing theme in the risks articulated above is that they are 'equity-like' in nature.

Don't throw the baby out with the bathwater

The CSA correctly identifies key risks associated with large real estate developments and these risks should be addressed. A few bad actors took advantage of investors by registering subordinated mortgage charges against real estate developments that were marketed as debt but really were, in all but name, equity or equity-like. We propose that, instead of removing the prospectus and registration exemptions and broadly impacting the entire alternative mortgage lending sector, the CSA should consider regulating the specific risks associated with real estate development loans. The simplest solution could be to remove the exemption on real estate development loans with loan-to-values in



excess of 85% that are based on legitimate third-party appraisals and on loans that are subordinate to 1st and 2nd positions.

Moral Hazard

The institutional lending space is highly regulated with a large supply of capital. Conventional borrowers benefit from this competitive lending space where they enjoy relatively low interest rates. People and entities who are not able to borrow conventionally need to turn to the alternative lending markets. These markets fulfil a need by providing a source of capital that the regulated financial institutions are not able to provide. Excess regulation of the alternative lending space threatens to remove capital, thereby increasing borrowing costs. This would be prejudicial to lenders, borrowers and the real estate market at-large.

The CD Howe Institute [published a paper](#) that studied the impact of regulation on housing prices and found that regulatory burdens have increased the cost of housing by an average of \$229,000 per home. We would like to suggest that removing the prospectus and registration exemptions would further exacerbate the problem because fewer lenders will participate which will drive up borrowing costs. This is of particular concern at a time when the B-20 rule changes will inevitably prevent an estimated 15% of borrowers from renewing their loans at the prior conventional rates that they were able to obtain before the B-20 changes.

Between the B-20 changes, taxing foreign investment in real estate, high consumer debt levels and increasing interest rates there are many potential pitfalls in Canadian real estate. Further increasing the borrowing costs for Canadian homeowners threatens to push people over the edge of affordability and we urge the CSA to consider the potential cost to the public when performing the cost benefit analysis.

Exempt Market Reports and Compliance Costs

Foremost is regulated as an Exempt Market Dealer in Ontario and it is our estimate that the incremental cost of being a CSA regulated entity is at least \$100,000 to \$200,000 per year. In addition, if you consider the fees when filing exempt market reports, the costs become prohibitively expensive. Not all syndicated funding is raised in one tranche which implies multiple \$500 exempt market report filing fees. These costs will make smaller mortgage syndications economically unviable and will likely push smaller mortgage syndicators out of the market. There would also be an increased possibility that the additional cost burden eliminates syndication of all mortgages other than on large development deals. While this may be the extreme case we believe with certainty that, in the very least, increased regulatory costs will drastically decrease the number of syndicated mortgages available. This will make it



more difficult for investors to create diversified portfolios and will make it harder for borrowers to obtain loans when their mortgages mature.

Suggestions for CSA's consideration

Perhaps the simplest solution could be to remove the exemption on real estate development loans with loan-to-values in excess of 85% that are based on legitimate third-party appraisals and on loans that are subordinate to 1st and 2nd positions.

In the event that the prospectus and registration exemptions for all syndicated mortgages are eliminated, we strongly urge the CSA to mitigate some of the damage to the industry by exempting syndicated mortgages from the \$500 exempt market filing fee. If an exemption from the filing fee is not possible please consider allowing reports to be filed for syndicated mortgages distributed over a 1-month period, as opposed to a 10 day period to make the fee burden less onerous. We also ask that you consider that in instances where the borrower assigns the obligation to file the reports to an EMD, that the EMD should be viewed as the issuer and should have the ability to file a report that includes all syndicated mortgage sales for the period in question on one report.

To illustrate the risk of imposing \$500 filing fees take a \$200,000 mortgage loan as an example. A lender would likely earn between \$2,000 to \$4,000 in fees on a loan of this nature. Having to file an exempt market report and pay \$500 each time a syndicated investor participates could amount to consuming the entire revenue with regulatory filing fees which is punitive and likely not within the spirit and intent of what the Proposed Changes are trying to achieve.

Alternatively, a simpler approach may be to allow the Private Issuer Exemption to be used on syndicated mortgages. This would mitigate the excessive fee burden associated with CSA regulation (including the exempt report filing fees) while still capturing the risks associated with large real estate developments. Loans on larger real estate development deals would most likely need to be syndicated to more than 50 investors so the Private Issuer Exemption would not apply. This, in conjunction with incorporating our suggestions of focusing regulation on loans greater than 85% LTV or being in 3rd position or worse, would be an elegant way of increasing investor protection while not snuffing out the syndication of smaller, less risky loans.



Responses to your questions

Appraisals

1. As proposed, an appraisal would be required in all cases where a syndicated mortgage is distributed under the OM Exemption. Should there be exceptions to this requirement? For example, should an appraisal be required if the property was acquired recently in an open market transaction with all parties acting at arm's length?

Response: This is not relevant to our type of lending which includes smaller loans. Offering Memorandums are so expensive that it is a certainty they would never be used when syndicating our loans. For larger real estate development loans it is possible that an OM would be used and, yes, in that circumstances an appraisal should be required even if there was a recent open market transaction at arm's length. There is always the possibility that the purchaser overpaid for the asset.

Mortgage broker requirements

2. Are there circumstances where requiring additional disclosure by and a certificate from a mortgage broker would not be appropriate in connection with the use of the OM Exemption? If so, please explain why and whether there are other participants in the distribution that should be subject to these requirements.

Response: No comment

3. Is it appropriate to require a mortgage broker to certify that it has made best efforts to ensure that the offering memorandum does not contain a misrepresentation with respect to matters that are not within its personal knowledge?

Response: No comment

Exclusion of syndicated mortgages from the Private Issuer Exemption

4. Are there circumstances where the distribution of syndicated mortgages under the Private Issuer Exemption would be appropriate and reporting to the securities regulatory authorities would not be necessary? If so, please provide examples and explain why there are limited investor protection concerns in those circumstances.

Response: Allowing the Private Issuer Exemption to be used on syndicated mortgages would mitigate the excessive fee burden associated with CSA regulation (including the exempt report filing fees). Since large real estate developments, and their increased inherent risks and larger loans sizes, would most likely need to be syndicated to more than 50 investors, the Private Issuer Exemption would not apply. This, in conjunction with incorporating our suggestions of focusing regulation on loans greater than 85% LTV or being in 3rd or worse position, would be an elegant way of increasing investor protection while not snuffing out the syndication of smaller, less risky loans.



Alternative prospectus exemptions

5. Should alternative prospectus exemptions be provided to facilitate the distribution of specific classes of syndicated mortgages where the investor protection concerns may not be as pronounced?

Response: Yes. For all loans less than 85% LTV that are in 1st or 2nd position.

6. Should we consider adopting an exemption for the distribution of syndicated mortgages on existing residential properties similar to the exemption for "qualified syndicated mortgages" under British Columbia Securities Commission Rule 45-501 Mortgages?

Response: No comment

7. Should an exemption be provided for the distribution of a syndicated mortgage to a small number of lenders on a property that is used for residential or business purposes by the mortgagor? If so, should the exemption be subject to conditions? For example, should the exemption be available only for a distribution: (i) by an individual; and/or (ii) relating to a residential property; and/or (iii) involving a specified maximum number of lenders?

Response: Trying to create specific exemptions such as the one listed above, in order to attempt to mitigate unintended consequences, will be difficult and could create significant regulatory confusion.

Closing Remarks

To summarize our feedback:

1. On the removal of the prospectus and registration exemptions for the distribution of syndicated mortgages – **We agree with removal of the exemptions on loans greater than 85% LTV or not in 1st or 2nd position.**
2. The introduction of additional requirements when relying on the OM exemption to distribute syndicated mortgages – **It is prudent to require appraisals**
3. On the amendment to the private issuer prospectus exemption so that it is not available for the distribution of syndicated mortgages – **We do not agree that this is optimal.**

When weighing the costs and benefits of the Proposed Changes please also include the potential for a significant adverse impact on borrowers who will not be able to get financing in an already tightening credit environment. If you do go ahead with the Proposed Changes please consider all possible cost mitigators to defray the increased regulatory cost.

Thank you for the opportunity to provide feedback on the Proposed Amendments. We hope you find our feedback constructive.



Please do not hesitate to contact Ricky Dogon, Chief Compliance Officer for Foremost Financial, at ricky@foremost-financial.com or 416-488-5300 ext. 269.

Sincerely,

A handwritten signature in blue ink, appearing to read 'Evan Cooperman'.

Evan Cooperman
CEO, UDP, Foremost Financial Corporation

A handwritten signature in black ink, appearing to read 'Ricky Dogon'.

Ricky Dogon
CCO, Foremost Financial Corporation