Vector Financial
SERVICES LIMITED
Brokerage Licence #10160, Administrator Licence #11205

May 14, 2019

The Secretary
Ontario Securities Commission
20 Queen Street West, 22nd Floor
Toronto, Ontario M5H 3S8
comments@osc.gov.on.ca

Re: CSA Second Notice and Request for Comment 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* and Companion Policy 31-103CP *Registration Requirements, Exemptions and Ongoing Registrant Obligations*.

Dear Sirs & Madame's,

Background of the Respondent

Vector Financial Services Limited (VFSL) has been engaged in the business of providing syndicated mortgages to investors and borrowers since 1969. We are currently licenced by FSCO as both a Mortgage Broker (licence # 10160) and Administrator (licence # 11205) and both licences are in good standing. We have developed an investor pool of primarily high net worth/accredited retail investors (>99%), sophisticated family office investors and institutional co-lenders. We currently manage a loan book of in excess of $250,000,000 and employ 10 individuals full time. Over the past 7 years we have originated and repaid in excess of $700 million to our investors and provided our investors with net returns of between 8.3% and 9% per annum with capital losses of no greater than 25 basis points during the entire period. We are not currently, nor have ever been, subject to any legal claim, threat or suit by any of our investors throughout our near 50-year history.

VFSL does not engage in mortgage brokering between a borrower and another lender except for a loan it will underwrite for itself and its clients. Thus while we are technically a broker to satisfy the requirements of FSCO, we are primarily investor-lender focused – you might consider us more of an alternative lender or mortgage banker.

VFSL welcomes the Proposal and its intent to enhance investor protection and improve regulatory harmonization. However, we note several concerns with the current proposal which are outlined below.

General Comments:

- Why 2 separate regulators?
- Revising the definition of Non-Qualified Syndicated Mortgages (NQSM)

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- Transition period too short (Prospectus exemption by Dec 31, 2019 and Registration exemption 12 months thereafter)
- Regulatory cost burden (upfront registration transition plus ongoing reporting) too high for small business
- Why are Syndicated Mortgages thought to be so risky – A Commentary

Why Not a Single Regulator Regime?

We believe the goal of increasing investor protections for syndicated mortgages is best achieved through a single regulator overseeing all mortgage capital-raising activities regardless of the characteristics of the mortgage whether it is done via syndications or a fund structure. The benefits of a single-regulatory regime are as follows:

- Reduced regulatory inefficiencies and costs
- Reduced administrative burden on investors and borrowers
- Avoids the potential for regulatory arbitrage
- Less confusing path to harmonization for all parties.

VFSL is now regulated by a single regulator (FSCO/FSRA). The introduction of the OSC as the regulator for the 'distribution' to investors/lenders of syndicated mortgage 'securities' still leaves the 'brokerage' and 'administration' functions to be regulated by FSCO/FSRA. Does it not make sense to regulate the registrant (i.e. VFSL) under one regulator like other participants in the capital markets? VFSL does not engage in traditional brokering (the brokering of a loan from a one arms length entity to another), nor employs any agents that broker deals between lenders and investor/lenders. We currently protect all investors with the newly enhanced KYC, Suitability and Disclosure (forms 3.0, 3.1, and 3.2) and reduced investment totals for non-accredited investors ($60,000 maximum per 12-month period), as required by FSCO/FSRA. Does this not cover the essence of the protection regulators are searching for?

Dual registration would necessitate reporting twice on the same activities via an Annual Information Return (FSCO/FSRA) and reports of exempt market distributions, possible duplicate errors & omissions coverage, separate and potentially overlapping educational and proficiency requirements for those individuals that liaise with the public (agent/broker requirements for FSCO/FSRA; dealing representative for EMD), and other duplicative efforts.

Would the firm be subject to two possible audits on the same material? Would the regulators share the findings between each other? Would the firm require two different forms of policies and procedure manuals? The list goes on and on about what can become very confusing for the registrant.

We believe a single regulator is in the best interests of all stakeholders.

Revising the Definition of Non-Qualified Syndicated Mortgages (NQSM)

In recent years there have been investments marketed as syndicated mortgages, where the risk of the investment was comparable to an equity investment in a large construction development deal. The risks associated with these investments were often improperly disclosed. Investors erroneously believed the loans were backed by real estate when in fact, with loans-to-value in excess of 100%, they were not. In

many cases, excessive commissions and other transaction related costs were deducted from the initial advance to borrowers leaving a wide gap of value that needed to be earned back by the project before additional profits could be distributed to investors.

We fully support the CSA's goal to draw a line between these investments and true syndicated mortgages. However, the current definition of QSM is too broad and arbitrary. There are numerous instances where a mortgage on a commercial property or one provided for construction purposes poses no greater risk than a residential mortgage (especially if the residential mortgage is in second position).

The security of a mortgage is dependent as much on property type as it is on loan-to-value, geography and the borrower (history and experience, credited rating and net worth etc.). A better definition of QSM would capture mortgages that are:

- Negotiated or arranged through a mortgage brokerage;
- At the time the syndicated mortgage is arranged, the amount of debt it secures, 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% of the fair market value of the property relating to the mortgage, including any value that may be attributed to proposed or pending development of the property;
- It is limited to one debt obligation whose term is the same as the term of the syndicated mortgage; and
- Net of reasonable administration fees, the rate of interest payable under the mortgage is equal to the rate of interest payable under the debt obligation.
- The investor is of a designated, accredited or FFBA's class of investors and by definition can absorb the risk of the investment.

We believe revising the definition of NQSM would mitigate many of the other concerns we have identified with the current proposal.

<u>Transition Period Too Short</u>

We have been following the regulatory comment process for the past 18 months and have attended and participated in meetings (both public and private) with regulatory staff (MOF, FSRA, OSC and politicians). We have always been working on the assumption of a two stage roll out of the dates for the termination of the prospectus exemption and the termination of the registration exemption which was broadcasted to be 12 months following the prospective exemption deadline.

Given there is still some regulatory confusion in the industry including the delayed roll out of FSRA, the continuing comment periods which are still open to the CSA, the non-finalization of Parliamentary Assistant Doug Downey's review of MBLAA 2006, the lack of clarity from any regulator as to the proficiency requirements for mortgage agents / brokers moving from FSCO/FSRA to the OSC, we believe the transition period is too short for firms like VFSL to figure out the most efficient regulatory set up.

We believe the transition period for the elimination of the registration exemption should be revised back to December 31, 2020 or 12 months following the end of the prospectus exemption in keeping with the original intent.

Regulatory Cost Burden Too High for Small Business (Upfront & Ongoing Reporting)

The upfront cost of VFSL converting to an EMD could be in excess of $100,000 when one takes into account the proposed 2 regulator regime, additional hires proficient in securities reporting and legislation and the additional legal costs of ensuring VFSL is abiding buy the regulations. As mentioned previously, serious consideration should be given to the concept of a single regulator.

We request clarification as to why the timing of the filing of a report of exempt market distribution (REMD) is outside the scope of this project. To many lenders, the REMD represents one of the larger financial and administrative costs associated with the proposed structure.

The argument that the cost of filing will be minor compared to the cost of mortgage registration fails to capture the realities of operating a syndicated portfolio. First, the industry recognizes the costs associated with registering a mortgage are borne by the borrower. Second, mortgage registration is a one-time cost which allows it to be accounted for when determining the total loan amount. Conversely, a syndicated mortgage may require multiple REMD's and it is therefore difficult to predict the frequency as new investors are often added to a mortgage throughout the term of the loan. Furthermore, construction mortgages, which include multiple draws and have different investors participate at each stage, could trigger multiple reports. These issues get compounded in the context of managing a syndicated portfolio and are particularly burdensome for small-to-medium lenders whose investors maintain small investment amounts diversified across multiple small loans with short terms.

To illustrate the implications of imposing a $500 filing fee, consider 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 size. Having to file exempt market reports and pay $500 each time a syndicated investor participates could amount to consuming the entire revenue with regulatory filing fees.

In short, given the potential high frequency and large number of REMDs that would need to be filed for syndicated mortgages, the cost to borrowers/lenders and to regulators to review these filings is out of proportion with the benefit gained by the delivery of this information to the regulator.

In order to reduce the administrative burden and expense while still ensuring the CSA remains up to date, we recommend the following:

- **Construction mortgages should require one filing at initial funding and subsequent advances should not trigger a REMD.**
- **A single monthly filing reflecting all activities during the month;**
- **Reduce the cost of the filing to account for the frequency; and**
- **Trades involving accredited and/or FFBA investors should not trigger a REMD.**

Why are Syndicated Mortgages thought to be so risky – A Commentary

We believe syndicated mortgages are being broadly miscategorised as high-risk investments which has an adverse impact on suitability analysis and unfairly portrays the industry in a negative light. Syndicated mortgages represent a diverse array of loans which can encompass residential or commercial

construction first mortgages with conservative loans-to-value (below 75%) or poorly documented/disclosed “equity-like” development loans with aggressive loan-to-values (> 95%) and which rank in a subordinated position. Determining the risk characteristics of the asset class should be assessed on a per-loan basis and the use of all encompassing statements fail to capture important nuances.

We further note the CSA’s response in the comment letter reaches an erroneous conclusion as it states that 6.6% of the reported syndicated mortgages resulted in a loss. In fact, according to the comment letter, only 3.8% of the 2,000+ mortgages resulted in some loss of principal or interest. Such data supports the argument that an individual syndicated mortgage or a portfolio comprising of lower risk private mortgages can be considered as low to medium risk. Has anyone studied how investors faired in owning block-chain technology companies or bitcoin ownership? Bitcoin peaked at almost $20,000 USD in December of 2017 and is now down almost 60%. None of VFSL mortgages has ever had this type of value change!

We maintain there is no pragmatic reason why mortgages should be treated differently than other securities and we request clarification as to why they are being segregated. For instance, issuers of bonds and debentures who collateralize their security with a mortgage result in a product substantially the same as a mortgage, nonetheless they are subject to different regulatory oversight (i.e. the permitted use of the private issuer exemption). Are there two types (qualified and non-qualified) of preferred shares offered in the capital markets? The answer is obviously no. There are different types of companies that issue preferred shares from large corporations like BCE to smaller junior oil and gas companies. Obviously the risk profile of each is quite different and not all investors are suitable for each type. The same concept could exist for syndicated mortgages and it is our job to ensure that investors risk tolerances are reflected in their choice of mortgages.

The atypical treatment of mortgages not only creates additional regulatory burden; it also impedes national harmonization.

We hope you will consider these comments and we are available to discuss these in depth with the CSA if they are so inclined.

Yours truly,
VECTOR FINANCIAL SERVICES LIMITED

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