

# CSA CONSIDERS REFORMS TO THE SYNDICATED MORTGAGE REGIME AND SEEKS INPUT FROM INDUSTRY PARTICIPANTS

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Overview of the Notice

In March 2018, the Canadian Securities Administrators (the "**CSA**") released CSA Notice and Request for Comment Proposed Amendments (the "**Notice**") to National Instrument 45-106 Prospectus Exemptions ("NI 45-106") and National Instrument 31-103 *Registration Requirements, Exemptions, and Ongoing Registrant Obligations* ("NI 31-103") relating to Syndicated Mortgages and Proposed Changes to Companion Policy 45-106CP *Prospectus Exemptions* (collectively, the "**Proposed Amendments**"). The Notice seeks comments with respect to changes to the prospectus and registration exemptions for the distribution of syndicated mortgages. The Notice proposes:

- removal of the mortgage prospectus exemption under section 2.36 of NI 45-106 and the dealer registration exemption for mortgage brokers under section 8.12 of NI 31-103 in the CSA jurisdictions where the exemptions are available;
- introduction of additional requirements to the offering memorandum exemption under section 2.9 of NI 45-106 (the "OM Exemption") that apply when the exemption is used to distribute syndicated mortgages; and
- amendments to the private issuer prospectus exemption under section 2.4 of NI 45-106 (the "Private Issuer Exemption") so that it is unavailable for the distribution of syndicated mortgages.

## Background

All CSA jurisdictions currently have prospectus and registration exemptions for securities that are mortgages (the "**Mortgage Exemptions**") if they are sold by a mortgage broker licensed in the Canadian jurisdiction where the property is located, although in Alberta, British Columbia, Manitoba, New Brunswick, Quebec and Saskatchewan (the "**Excluded Provinces**") the Mortgage Exemptions are not available for syndicated mortgage. The Proposed Amendments define a syndicated mortgage as a mortgage in which two or more persons participate directly or indirectly, as a lender in a debt obligation that is secured by the mortgage. According to the CSA, there has been a significant increase in the offering of syndicated mortgages in

connection with real estate developments in certain jurisdictions. Furthermore, these financings raise investor protection concerns, particularly when sold to retail investors as they may, amongst other considerations, be offered by issuers with no source of income rendering the payment of ongoing interest dependent on future financings or reserves from the principal advanced, not be fully secured by charge against real property due to the amount of the loan potentially exceeding the fair market value of the real property, and be subordinate to future financings which may be substantial and increase the risk profile of the investment.

## **Summary of Proposed Amendments**

### **Changes to the Mortgage Exemptions**

Consistent with the current approach in the Excluded Provinces, the Proposed Amendments, together with related legislative amendments in Ontario would remove the Mortgage Exemptions for syndicated mortgages in Newfoundland and Labrador, the Northwest Territories, Nova Scotia, Nunavut, Ontario, Prince Edward Island, and Yukon (the "**Included Provinces**"). Accordingly, alternative prospectus exemptions would be required for the distribution of syndicated mortgages in all CSA jurisdictions. In those jurisdictions where the Mortgage Exemptions currently apply to syndicated mortgages, market participants that are in the business of trading syndicated mortgages would be required to consider whether the registration requirements apply to them. In the Included Provinces, the amendment to the registration exemption will be made effective one year later than the change to the prospectus exemption to allow for market participants to register as required.

### **Changes to the Offering Memorandum Exemption**

The Proposed Amendments will require issuers distributing securities in reliance on the OM Exemption to, amongst other requirements:

- deliver an appraisal respecting the fair market value of the property subject to the syndicated mortgage prepared in accordance with applicable professional standards by a "qualified appraiser" who is independent of the issuer to prospective purchases under the OM Exemption. The appraisal must also be filed with the applicable securities regulatory authorities on or before the 10th day after the distribution of the syndicated mortgage;
- consistent with the current approach in British Columbia, include supplemental disclosure requirements tailored to syndicated mortgages related to development risks, prior obligations secured against real property and the price paid by the developer to acquire the real property;
- issuers of syndicated mortgages would be required to meet the requirements of Form 45-106F2 *Offering Memorandum for Non-Qualifying Issuers*, as supplemented by the proposed Form 45-106F18 *Supplemental Offering Memorandum Disclosure for Syndicated Mortgages*. These new disclosure requirements would require information regarding the business and financial position of the borrower

under the syndicated mortgage. In addition, detailed information would be required to be disclosed respecting the property that is subject to the mortgage, the material terms pertaining to the syndicated mortgage, the key terms of relevant guarantees or similar financial commitments, the financial position and business experience of the person providing the guarantee or other financial commitment as well as information about the developer if the property subject to the syndicated mortgage is in development. Furthermore, disclosure would be required respecting the principals of the relevant mortgage broker. Finally, disclosure would be required respecting whether a mortgage broker has provided a disclosure statement under mortgage broker legislation to the borrower concerning all related fees; and

- Any mortgage broker involved in the distribution of a syndicated mortgage under the OM Exemption would be required to provide a certificate that the offering memorandum does not contain a misrepresentation with respect to matters within its knowledge and that the mortgage broker has made best efforts to ensure that matters that are not within its knowledge do not contain a misrepresentation, similar to the current approach in British Columbia.

### **Changes to the Private Issuer Exemption**

The Proposed Amendments would make the Private Issuer Exemption unavailable for the distribution of syndicated mortgages. The CSA explicates that its removal would result in more consistent reporting for syndicated mortgage distributions by requiring issuers distributing syndicated mortgages to file a report of exempt distribution with the applicable securities regulators providing the securities regulators with more information about this market.

### **Ramifications for Industry Participants**

The CSA highlights the following ramifications for industry participants if the Proposed Amendments are adopted:

- enhanced investor protection through additional disclosure and involvement of a registrant;
  - market participants in jurisdictions where syndicated mortgages may currently be offered in reliance on the Mortgage Exemptions may require registration as an exempt market dealer,
  - ongoing compliance obligations, the adoption of new policies and procedures, and an increase in associated costs; and
- the necessity of obtaining property appraisals and providing supplemental disclosure under the OM Exemption.

### **Conclusion**

The CSA has posed a comprehensive set of consultation questions in the Notice regarding the status quo of the

distribution of syndicated mortgages and the harmonization of the regulatory framework for syndicated mortgages across all CSA jurisdictions. The deadline for submitting comments to the CSA is June 6, 2018. Please contact a member of McMillan's Capital Markets Group if you have any questions or seek assistance with the preparation of a comment letter.

by Michael Shannon and Alex Bruvels

### **A Cautionary Note**

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

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