VAULT CAPITAL INC.
FSCO Licence #12377

November 18, 2019

Financial Services Regulatory Authority of Ontario
5160 Yonge St., (16th floor)
Toronto ON, M2N 6L9

Re: Comment on FSRA's Draft Statement of Priorities and Budget

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Vault Capital Inc. ("Vault") is a Toronto based private mortgage lending company. Vault manages approximately $170MM which is funded by over 300 retail investors as well as institutional capital sources. In order to compliantly carry out our lending activities, Vault has a mortgage brokerage (FSRA licence #10890), a mortgage administrator (FSRA licence #12377) as well as a captive Exempt Market Dealer (Vault Exempt Market Services).

We appreciate the Financial Services Regulatory Authority of Ontario ("FSRA") request for comment on FSRA's draft statement of priorities and budget. To date we have been encouraged by FSRA's inclusion of market participants in formulating their policies.

We were also encouraged by many of the suggestions that the Ministry of Finance ("MoF") proposed in their September review of the Mortgage Brokers Lenders and Administrators' Act ("MBLAA"). We concur that there needs to be a focus on pragmatic regulatory reduction that balances investor protection with business efficiencies. We also agree that the current standards and practices of capital raising activities for syndicate mortgages require additional protocols. Subsequently, many of the proposals outlined in this letter either mirror or extrapolate on the MoF's legislative review of the MBLAA as we feel they should form the basis of FSRA's priorities. Of note we want to highlight the following:

1) The need for a new class of licence for syndicate mortgage lending;
2) Elimination of unnecessary duplication and creating harmonization between the capital raising regimes overseen by the Financial Services Regulatory Authority of Ontario ("FSRA") and the Ontario Securities Commission ("OSC"); and
3) Tailoring regulation to account for the sophistication of the participants.

Licensing:

The mortgage lending landscape in Canada has changed over the last 10 years and alternative mortgage lenders are playing a more important role in assisting homeowners in their financial needs. Alternative mortgages (also known as private mortgages) provide the Ontario

population with much needed mortgage products to fill the gap not met by institutional lenders. New immigrants, entrepreneurs, and self-employed Ontarians have been able to purchase homes and inject capital in their business because of alternative mortgages. Furthermore, alternative mortgages provide a steppingstone towards institutional lenders who ultimately provide longer term debt options at lower costs.

Alternative mortgages also play an integral roll in real estate development projects. Although 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 the name, equity or equity-like investments. The majority of development projects involving alternative mortgages have resulted in Ontario's builders having access to capital and, when marketed correctly, have also provided investors with real estate investment exposure without taking equity risk.

Given the importance of alternative mortgages, it is essential that they are regulated in a manner which doesn't impede the flexibility of the product. Oversight should not focus on the product features. Rather, it should be focused on the participants who arrange and invest in alternative mortgages to ensure that investors and borrowers are entering a product that is suitable.

To address this and better regulate that segment of the industry, a separate regulatory category should be created for mortgage syndicators, MICs and Mortgage Funds (collectively, "Alternative Lenders") who engage in mortgage lending as opposed to brokering activities. Traditional mortgage brokers solicit loans and present them to various funding sources. Whereas Alternative Mortgage Lenders source, underwrite and then fund loans either from captive pools (funds) or via syndication to a group of suitable investors. There is a notable distinction between each group's activities, and it is often the case that a registrant focuses either on mortgage brokering or mortgage lending. By creating regulations that bifurcate the two activities we can ensure that:

- Instances of duplicative or non-applicable regulatory burden and costs are minimized;
- Education and proficiency requirements are be targeted and effective; and
- An enhanced investor protection regime can be created.

Currently, there are numerous instances of irrelevant and/or duplicate costs being imposed on Alternative Mortgage Lenders. One example is the requirement for E&O insurance. These policies are costly and do not cover events / risks that are relevant to Alternative Mortgage Lenders. Moreover, these are regulatory costs that offer no corresponding benefit or protection to investors. A more meaningful requirement would be for fraud insurance on Alternative Mortgage Lenders' trust accounts. Furthermore, it is common for Mortgage Lender's capital raising activities to also be registered under security regulators like the Ontario Securities

Commission ("OSC"). Under the OSC's regime the registrant is also required to maintain insurance resulting in a duplication of insurance costs for a similar activity.

Working capital requirements provide another example. Mortgage administrators are required to maintain and track $25,000 of unimpaired working capital whereas exempt market dealers must maintain and track $50,000. Not only is the cumulative amount difficult for smaller businesses it is another example of where harmonization could reduce regulatory burden and costs on registrants.

A new regulatory category for Alternative Mortgage Lenders should also include a new designation/license that must be obtained for someone to act as a dealer of syndicated mortgages. Currently, all that is required to distribute syndicated mortgages is to be licensed as a Mortgage Agent. The certification process does not provide sufficient material or guidance to properly prepare someone to distribute syndicated mortgages to investors. Furthermore, the relevant proficiencies are practically non-existent and have no correlation to capital raising activities nor investor protection. Subsequently, it has resulted in an inadequate investor protection regime. Having a separate licence for brokering alternative mortgages with targeted proficiencies and education requirements would resolve this issue. Furthermore, we contend that the licence:

- Should be an add on to a mortgage agent/broker licence as most mortgage agents/brokers do not participate in capital raising;
- The requirements should mirror those of security regulators to avoid regulatory arbitrage and to create a level playing field between mortgage agents/brokers and securities registrants; and
- Should be required of lawyers who wish to distribute syndicated mortgages as they are currently permitted to without any real pertinent training.

Furthermore, there should be a carve out for individuals who are already registered with security regulators ("Registrants") in order to reduce regulatory burden and costs. This exclusion accounts for the fact that the pre-requisites to become a Registrant and the regulatory regime Registrants operate under the OSC is specifically designed to promote prudent capital raising activities.

Tailored Regulations:

Mortgage syndication is integral to the mortgage industry as it promotes investor protection by allowing investors to build customized and diversified portfolios that fit their specific needs, lending strategies and risk tolerance. Furthermore, some mortgage investment entities ("MIE's") use mortgage syndications to mitigate risk by reducing single loan or borrower exposure and increasing liquidity in their pooled funds. It is also important to note that the

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investors of MIE's have been onboarded through Registrants and in many instances the MIE's are captive exempt market dealers.

Given the importance of syndication, it is paramount that regulations take a pragmatic approach to balancing investor protection while allowing MIE's to manage their liquidity and concentration risks and without causing unnecessary regulatory burden on both investors and registrants. An avenue to achieve this is to tailor the regulatory requirements based on the sophistication of the participants. The degree of know your client ("KYC"), know your product ("KYP") and suitability obligations should be based on the sophistication of the investor. The MBLAA already has bifurcated investors between sophisticated (Designated Class of Investors) and non-sophisticated (Non-Designated Class of Investors). We contend that FSRA's current KYC, disclosure and suitability forms should not be required when dealing with a Designated Class of Investor instead a principal-based system, akin to the OSC's, should be adopted.

Furthermore, special consideration needs to be taken for sophisticated lenders who syndicate amongst themselves. The following list of sophisticated lenders should be precluded from KYP and suitability requirements and a commonsense test should be applied to determine KYC.

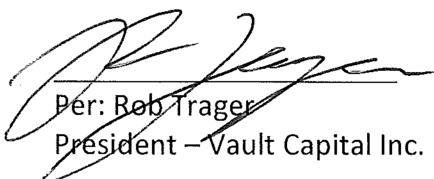
1) Regulated deposit taking institutions;
2) Mortgage brokers and agents (who are licensed under the new class of lending license);
3) Publicly listed reporting issuers and entities; and
4) Operating entities like MIC's, mutual fund trusts and GP/LP that onboard their investors through a Registrant, as well as their officers and directors, that the brokerage/administrator has a contract to manage the operating entity.

Tailored regulations can balance investor safeguards and business efficiencies. However, the effectiveness of the regulations will ultimately be based on the quality of the registrant. Subsequently, it is important that the aforementioned proposals are not dealt with in isolation as we need to ensure that strong regulations are being upheld by qualified market participants.

Closing Remarks:

Thank you for taking the time to consider our concerns. We recognize that this letter mainly outlines larger concepts to consider and as such Vault would be happy to work with FSRA, the MoF and the OSC to apply these concepts to actionable specifics that can be implemented in the MBLAA and upheld by FSRA's regulatory regime.

Best Regards,



Per: Rob Trager
President – Vault Capital Inc. and Vault Mortgage Corporation