

INVESTOR ADVISORY PANEL

September 21, 2020

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- RE: FSRA Consultation 2020-007
Supervision approach for Non-Qualified Syndicated Mortgage Investments with permitted clients and legacy Non-Qualified Syndicated Mortgage Investments**
- RE: OSC Consultation
Amendments to OSC Rule 45-501 *Ontario Prospectus and Registration Exemptions* to clarify the definition of “qualified syndicated mortgage” and to expand proposed amendments relating to mortgages**
- RE: CSA Notice of Amendments to NI 31-103 and NI 45-106
Registration requirements, exemptions and ongoing registrant obligations relating to syndicated mortgages**

The Ontario Securities Commission’s Investor Advisory Panel (IAP) welcomes this opportunity to comment on the above-noted plans and proposals for regulation of syndicated mortgage investments. The IAP is an initiative of the OSC to ensure investor concerns and voices are represented in the Commission’s policy development and rulemaking process. Our mandate is to solicit and articulate the views of investors on regulatory initiatives that have investor protection implications.

Our comments reiterate concerns we raised with Ontario's Financial Services Regulatory Authority (FSRA) a year ago – especially our concern that threshold dangers posed by syndicated mortgages for retail investors are not being addressed in the regulatory measures currently under consideration.

Syndicated mortgages are complex instruments that can easily be misunderstood by inexperienced investors. Regrettably, under the proposed measures, many of those investors will continue to be artificially deemed sophisticated by virtue of their income or assets, and consequently they will still get swept in with those to whom marketing campaigns for syndicated mortgage investments are directed.

But, as investor advocates have noted for years, wealth is not a valid indicator of investment understanding or sophistication, and perpetuating this simplistic and faulty concept is no longer appropriate in an era where regulatory policy is meant to be evidence based. Policymakers should be correcting this approach as part of any package of reforms to syndicated mortgage regulation. Priority, therefore, should be given to developing and adopting a genuine test for measuring an investor's financial acumen and ability to evaluate risk. Nothing less will truly justify taking a lighter-touch approach to protection for investors with those capabilities.

Furthermore, regulators should be mindful of the fact that syndicated mortgages can be misrepresented, and mistakenly viewed, as being safe and secure when they are aggressively marketed to the public as "secured" investments. It is this literally factual but disingenuously misleading characterization that places unsuspecting retail investors at risk.

We believe this problem can be mitigated only by prohibiting representations and statements that imply a syndicated mortgage is a safe or secure investment. In addition, marketing materials and presentations should be prohibited from containing statements that the investment is "mortgage-backed" or "secured by a mortgage registered on title" unless the materials and presentations immediately state, with equal prominence, that:

- (a) the mortgage does not make the investment secure or guarantee repayment because the value of the land may be insufficient to cover all debts, including those that may rank ahead of the syndicated mortgage lenders, and
- (b) a syndicated mortgage therefore is an inherently risky investment in which investors may lose some or all of the money they invest.

It is imperative that these qualifying statements be included prominently in all marketing materials and presentations. The warnings will not be effective if they are only conveyed later in the subscription process or solely through disclosure documents at the point of sale.

This is not to say that risk disclosure documents should be eliminated. Disclosure is important for transparency and accountability, but research has highlighted the limits of disclosure as an aid for retail investors who are not sufficiently sophisticated to understand the significance and implications of the information disclosed. Unsophisticated individuals, by the very fact that they lack financial knowledge and understanding, are not well positioned to benefit from disclosure; and the data consistently indicate that most Canadians have low levels of financial knowledge and understanding.

It should be kept in mind, too, that disclosure documents, no matter how well-drafted, are unlikely to be read or comprehended in any real sense where they are presented to the investor embedded in a mass of papers to sign, as is typical in the syndicated mortgage subscription process. In these circumstances the information blizzard can quickly overwhelm many investors and leave them unable to absorb and understand the risk disclosure or fully fathom its implications.

In short, disclosure – especially late stage disclosure – is not a highly effective tool for protecting unsophisticated investors. At best, its utility is limited, and regulators should cease turning to it as the principal mechanism for mitigating risk and delivering investor protection, particularly in regards to syndicated mortgage investments.

Lastly, we urge Ontario's regulators to make sure the dividing line between the responsibilities of FSRA and the OSC for overseeing syndicated mortgages is made, and kept, absolutely clear. The current proposals draw a convoluted demarcation line that is affected by numerous factors including commercial development aims of the project, loan-to-value ratios, and investor classification as an institutional party or high net worth individual. We see this as a major concern and potential source of confusion, given the complexity of the jurisdictional design that has been developed. It is essential, however, that investors not be exposed to potential harm from gaps in regulatory coverage as a result of oversight being split between two agencies.

We wish to thank you for this opportunity to comment on your initiatives and we will be pleased to discuss them further with you, if you wish.

Sincerely,

A handwritten signature in blue ink, appearing to read "Neil Gross".

Neil Gross

Chair, Investor Advisory Panel