Financial Services Regulatory Authority of Ontario

Approach

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Supervision Approach for High-risk Syndicated Mortgage Investments (for Transactions prior to July 1, 2021)

Purpose

This Approach outlines FSRA's principles and requirements related to syndicated mortgage investments that have characteristics associated with a high-risk syndicated mortgage transaction ("High-Risk NQSMI") prior to July 1, 2021.

Scope

The Approach applies to mortgage brokerages transacting in High-Risk NQSMIs prior to July 1, 2021.

Rationale and context

In its first-year priorities, FSRA has identified enhanced consumer protection of investors in high risk mortgages.

FSRA is committed to strengthening protections available to investors in High-Risk NQSMIs. Mortgage brokerages and mortgage administrators must provide adequate disclosure of the risks associated with syndicated mortgages in a way that is easily comprehensible to and can be readily understood by investors.

We require investors and FSRA to be aware of syndicated mortgage investments that bear the characteristics associated with a high-risk transaction.

For investors, this means they will be better informed of the risk and able to make a more informed investment decision according their risk tolerance and investment sophistication.

For FSRA, this Approach facilitates real-time data collection, which enables us to identify when High-Risk NQSMIs are being marketed to retail investors. FSRA can then take immediate action to investigate these transactions, which could lead to suspension or revocation of a mortgage brokerage's licence and/or enforcement proceedings to seek an Administrative Monetary Penalty ("AMP") if the disclosure requirements for High-Risk NQSMIs are not being adhered to or if the marketing, sale or distribution of these products is not in compliance with obligations under applicable law and regulations.

General framework of the approach

Accountable Governance – FSRA relies on the principal broker and the brokers in a mortgage brokerage to implement and adhere to an appropriate supervision framework for a brokerage's operations and to provide oversight over the actions of its agents and brokers, particularly with respect to High-Risk NQSMIs (but not limited to the products).

Risk-based – FSRA's level of regulatory supervision of a brokerage will depend on the nature, size, complexity and risk profile of the brokerage. Where identified risks in a particular brokerage are higher, such as those related to High-Risk NQSMI transactions, the level of regulatory supervision will increase accordingly.

Principles

Key principles

Data-driven judgement – FSRA is focused on collecting data from brokerages and using it to appropriately assess and target supervision on those brokerages identified as higher risk.

Proactive – FSRA has been (e.g., by identifying those brokerages engaged in High-Risk NQSMI transactions) and will continue to create forward-looking risk assessments of brokerages, to implement processes to identify issues earlier and take actions for timely intervention, as required.

Targeted – FSRA will, as early as practicable in the sales and mortgage processes, focus on High-Risk NQSMI transactions offered to retail investors and on those brokerages that are potentially exposing those retail investors to the highest risk of loss. Retail investors generally have less knowledge, experience and resources to properly assess risks and absorb potential losses associated with High-Risk NQSMIs.

Processes and practices

FSRA has established processes and practices to guide its supervisory action related to High-Risk NQSMIs.

High-risk Syndicated Mortgages / Risk-based Framework

Based on an analysis of 246 syndicated mortgage projects over the past several years (2011-2018), FSRA has identified the three risk factors below as the key characteristics associated with High-Risk NQSMIs which can potentially result in harm to retail investors.

High Loan-to-Value Ratio	In transactions where the loan-to-value is equal to or greater than 100% (e.g., once all debt with equal or greater priority to the syndicated mortgage is fully drawn), there is risk that the mortgage security may not be enough to cover the syndicated mortgage if the investment project fails. The value of the property used for appraisal purposes must be the value of the property based on its current condition, use and zoning as of the appraisal date.
Subordination and/or Postponement	If the ranking or **repayment priority** of the syndicated mortgage can be changed or postponed, there is risk that the priority of the syndicated mortgage may be lowered (‘subordinated’ or “postponed”) behind other debt, potentially leaving investors with insufficient security to cover their syndicated mortgage investment.
Conflicts of Interest	In transactions where the borrower/developer is “related” (meaning that there a common relationship between them either because they are two companies under common ownership or control or otherwise in a relationship whereby one party can influence the other or can be influenced by a common third person) is to the mortgage administrator, there is a risk that the mortgage administrator may not be independent of the borrower/developer and may favour the interests of the borrower or developer over those of the investors which is a contravention of the administrator’s fiduciary duty. That is, the administrator may not properly represent the best interests of investors against the borrower/developer due to a conflict between the interests.

FSRA requires brokerages to provide retail investors a supplemental disclosure form for syndicated mortgage transactions that have one or more of the above-noted characteristics of High-Risk NQSMIs. See disclosure, Form 3.2.1 which, is part of Form 3.2.

Mortgage brokerages who deal with designated investors[1] will not be affected by this targeted approach.

Mandatory Supplemental Disclosure

For High-Risk NQSMIs, mortgage brokerages are required to submit to FSRA a new **Form 3.2.1 – Supplemental Disclosure for Retail Investors in a High-risk Syndicated Mortgage**, in addition to the already required disclosure form 3.2.

The summary disclosure provided in Form 3.2.1:

- provides retail investors who wish to invest in High-Risk NQSMIs with a clear warning that the investment is risky;
- outlines the specific risks related to high-leverage mortgage security, and whether there are related parties involved in the syndicated mortgage transaction; and
- summarizes the fees payable to the mortgage brokerage, broker and/or agent and any related parties for the High-Risk NQSMI.

Compliance

Real-time Review of High-risk Syndicated Mortgages

- Effective June 8, 2019, FSRA Rule 2019-001 (“Assessments and Fees”) requires that mortgage brokerages must file with FSRA the investor disclosure form (3.2) within five (5) calendar days of providing it to the **first** potential or actual investor in a non-qualified syndicated mortgage, along with a $200 fee to reflect FSRA’s costs.
- In addition, mortgage brokerages must file the supplemental disclosure form (3.2.1) within five (5) days of providing it to the **first** potential or actual retail investor in a high-risk syndicated mortgage. The filing of this form does not require payment of an extra $200, if the fee has already been paid with the filing of a form 3.2 for the syndicated mortgage.
- Filing of the forms with FSRA is not required for each subsequent potential or actual investor in a syndicated mortgage; however, the disclosure Forms 3.2 and 3.2.1 must be provided to each potential or actual investor.
- As a result of the Assessment and Fees rule and supplemental disclosure, FSRA will

capture real-time data including but not limited to the amount, nature and purpose of new non-qualified syndicated mortgage transactions. At any time, FSRA may follow up with brokerages to better understand the transactions in which they are involved, to ensure consumer protection. However, FSRA's resources are focused on higher-risk transactions linked to retail investors and based on a targeted approach of focusing on the above characteristics.

FSRA will reach out to mortgage brokerages that have brokered high-risk syndicated mortgages in the past to ensure they are submitting fees and the required forms appropriately. Where they are not, FSRA will take appropriate action (e.g., enforcement and onsite reviews).

Enforcement

FSRA has a range of enforcement options that may be engaged in instances of non-compliance with the supplemental disclosure requirement. These enforcement options include suspension or revocation of licence and/or AMPs.

Outcomes

For the consumer – The new supplemental disclosure form:

- Promotes greater awareness that certain syndicated mortgages can be high-risk investments and that they should understand these risks before making a decision to invest their money in these products.

For the regulator – The new supplemental disclosure form:

- Enables FSRA to quickly assess the level of risk of the mortgage transaction in real-time, to identify when high-risk transactions are being marketed and then take action. Actions could include suspension or revocation of a brokerage's licence and/or requiring the payment of an AMP if the required disclosures or filings are not completed correctly and/or on a timely basis or if the syndicated mortgage transactions do not otherwise comply with applicable law and regulations.
- Allows for real-time data collection through the filing of supplemental disclosure forms that will provide FSRA with an enhanced understanding of the syndicated mortgage market overall and the role of high-risk transactions.

For the industry – The new supplemental disclosure form:

- Fosters professional conduct and practices, deterring deceptive or fraudulent conduct

through appropriate additional regulatory burden for a small percentage of mortgage brokerages engaged in high-risk transactions.
- Supports increased confidence in the syndicated mortgage market by clearly identifying high-risk transactions.

FSRA is committed to promoting high standards of business conduct, protecting the rights and interests of consumers, and fostering, strong, sustainable, competitive and innovative financial services sectors. This approach and the related supplemental disclosure form is consistent with FSRA's desire to fulfill these commitments now and in the future.

Effective date and future review

This Approach was effective November 12, 2019. It was updated on March 10, 2021 to update its application period in order to reflect the transfer of regulation of non-qualified syndicated mortgage transactions with non-Permitted Clients to the Ontario Securities Commission effective July 1, 2021.

The latest possible date for FSRA to initiate a review of this Approach will be March 1, 2024.

About this guidance

Approach documents describe FSRA's internal principles, processes and practices for supervisory action and application of CEO discretion. They do not, of themselves, create compliance obligations. Visit FSRA's Guidance Framework to learn more.

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[1] The designated classes of investors are defined in Section 2 of Ontario Regulation 188/08 (Mortgage Brokerages: Standards of Practice). These include classes for individuals who have net income before taxes and net financial assets above a defined limit.