ISSUES FOR CONSIDERATION

The financial services market has become significantly more complex and diversified since the *Mortgage Brokers Act* (MBA) was enacted in 1972. Some stakeholders suggest that the legislation has not kept pace in a number of areas. In particular, the following topics have been identified as areas where legislative change may be required to enhance borrower and investor protection or improve efficiency in the mortgage marketplace.

A. Scope of the MBA

The original policy goal of the MBA was to prevent harsh and unconscionable mortgage transactions that were being carried out by persons who tacked on fees to the face rate of a mortgage without disclosing the effect of the fee on the true cost of borrowing. To address this problem, the MBA required persons carrying on activities captured by the definition of "mortgage broker" to register their business address and provide borrowers with true cost of borrowing disclosure if the mortgage broker charged a finder's fee or other charge.

The financial services market has changed profoundly since 1972. Changes include the variety in the type of mortgage products available, securitization of mortgage pools (i.e. asset-backed commercial paper), reverse mortgages, syndicated mortgage investments, the emergence of non-traditional mortgage lenders and the increased role of mortgage brokers as intermediaries in arranging mainstream residential mortgages.

Although regulatory requirements under the MBA have expanded to reflect these changes, including requirements for investment and conflicts of interest disclosure, education, trust account reporting, written administration agreements and minimum capital, a fundamental analysis of who should be regulated under the statute has not been conducted.

The scope of persons regulated under the MBA is captured in the definition of "mortgage broker" which means a person who does any of the following:

(a) carries on a business of lending money secured in whole or in part by mortgages, whether the money is the mortgage broker's own or that of another person;

(b) holds himself or herself out as, or by an advertisement, notice or sign indicates that he or she is, a mortgage broker;

(c) carries on a business of buying and selling mortgages or agreements for sale;

(d) in any one year, receives an amount of $1000 or more in fees or other consideration, excluding legal fees for arranging mortgages for other persons;

(e) during any one year, lends money on the security of 10 or more mortgages;

(f) carries on a business of collecting money secured by mortgages.

Although the mortgage marketplace has changed, it is still important to ensure it operates efficiently and protects consumers. At the same time, regulatory overlap or excessiveness is generally not desired. For example, the capital raising activities of mortgage brokers are also regulated under the *Securities Act* and cost of borrowing disclosure is regulated under the *Business Practices and Consumer Protection Act.* Ideally, regulation under the MBA would capture a comprehensive, but not over-inclusive, set of persons without regulatory overlap.

Questions:

1) *Does the definition of "mortgage broker" adequately capture the range of mortgage brokering activity in the current marketplace? If not, what are the types of mortgage brokering activity that fall outside the current definition of "mortgage broker"?*
2) *Do you think the definition of "mortgage broker" is over-inclusive? Are there any types of mortgage brokering activity that should not be captured by the definition of "mortgage broker"? For example, is it appropriate to regulate mortgage lenders or mortgage administrators under the MBA?*

B. Regulatory Framework

Linked to the issue of who should be regulated under the MBA is the issue of who should do the regulating. Currently, the Registrar of Mortgage Brokers (Registrar) is appointed by government and is responsible for registering, investigating and disciplining mortgage brokers. However, some industry participants have suggested that it is time to transform the current regulatory framework into a self-regulating model that would see mortgage brokers become responsible for administering and enforcing public regulation of their business practices, including licensing, standard setting, compliance monitoring and enforcement and complaint resolution.

A key part of self-regulation is an oversight system that ensures regulation is generally conducted in the public interest. For example, under the *Real Estate Services Act* (RESA) the Real Estate Council of British Columbia is the self-regulating body responsible for the licensing, education and discipline of real estate service providers. However, the following oversight powers are also in place under RESA:

- the government-appointed Superintendent of Real Estate can take disciplinary action if a licensee is acting contrary to the public interest and the Council has not yet taken action. In addition the Superintendent is responsible for investigating and taking action against unlicensed activity under RESA;
- the government has power to make regulations that override Council's rules; and
- the Minister of Finance can conduct a review of the Council's operations.

Currently, Alberta and Quebec are the only Canadian jurisdictions with a self-regulating framework for mortgage brokers. In Alberta, the Real Estate Council of Alberta is responsible only for regulating mortgage originators who bring borrowers and lenders together and not for regulating mortgage lenders or traders.

Questions:

1) *Should a new regulatory framework be developed to make the mortgage broker industry self-regulating?*
2) *If you think a self-regulatory framework should be established, what organization would take on the regulatory responsibility and what types of mortgage brokering activities do you think should fit within the regulator's responsibility?*

C. Statutory Obligations

The MBA places most statutory duties and obligations on the business entity registered as a mortgage broker while imposing few duties on the individuals employed as submortgage brokers by the business. For example, the MBA places the responsibility to provide disclosure on the mortgage broker, although the mortgage broker's responsibility in respect of conflict of interest disclosure only is extended to conflicts that submortgage brokers employed by the mortgage broker may have. This is in contrast to the requirements under the RESA which impose certain obligations directly on individual licensees including disclosing latent defects or conflicts to a client and reporting a failure to receive a deposit to the brokerage.

The RESA also establishes a clear accountability model that requires brokerages to designate a managing broker who is responsible for the conduct of the business

including supervision of its licensees. The managing broker must complete additional education and licensing requirements to better match statutory responsibility with qualifications. Ontario and Saskatchewan specify that a mortgage brokerage must designate a "principal broker" to perform prescribed supervisory duties.

To more clearly define the responsibility of mortgage brokers and their relationship with employees, the Registrar requires mortgage brokers as a condition of registration to nominate a "designated individual" who is responsible for the conduct of the business and its submortgage brokers. However, some stakeholders have suggested that this condition does not provide an accountability framework that is as clear as those established under other statutes.

Questions:

1) *What concerns, if any, would you have if the MBA required mortgage brokerages to designate an individual to perform specified supervisory duties and be responsible for compliance?*
2) *Do you have any suggestions on how a supervisory framework should be structured?*
3) *What disclosure obligations, if any, do you think the MBA should impose on submortgage brokers?*
4) *What suggestions do you have for the education and experience qualifications for the person responsible for the mortgage brokerage business?*

D. Classes of Registrants

There are four basic types of "mortgage brokers" that fall within the scope of the MBA:

- mortgage lenders who lend their own money, including banks, credit unions, deposit taking trust companies (all of which are exempted from registration), loan companies, mortgage investment corporations and private lenders;
- mortgage originators who bring borrowers and lenders together;
- mortgage dealers who sell investments in mortgages; and
- mortgage service companies that collect payments secured by mortgages (and often provide other service functions).

The MBA does not differentiate between persons who engage in these different types of mortgage broker activities. Some industry participants have suggested that different classes of registration should be established as each activity may require different

levels of expertise and present different types of risk to the consumer. Classes of registration may be structured to rationalize or streamline education, financial reporting and other regulatory requirements, or to contain limitations and conditions that reflect the risk inherent in each class. Creating classes of registration could also make the mortgage industry more accountable for complying with regulatory requirements and promote fair competition within the industry.

Questions:

1) *What are your views on establishing classes of registrants under the MBA?*
2) *If you support establishing classes of registrants, what would be the appropriate classes? What educational, financial reporting or other regulatory requirements, limitations or conditions do you think should apply to the applicable classes?*

E. Exemptions

Certain entities, including insurance companies, credit unions, banks, deposit taking trust companies and lawyers, are exempt from the MBA registration requirements because they are subject to consumer protection and regulatory requirements under other regulatory statutes.

Section 11 provides an exemption from registration for persons employed by savings institutions, which includes banks and credit unions. This has become an issue for some mortgage brokers in BC who claim that some bank representatives are either brokering or co-brokering mortgage applications and placing borrowers with lenders other than the bank that employs them. There may also be a consumer protection element to the problem, as borrowers who are dealing with a bank employee may find themselves being offered a mortgage product with a lender they have never heard of.

Some Canadian provinces that have recently reviewed their mortgage broker statutes now exempt entities providing simple referrals. In addition, Ontario provides a specific exemption for mortgage lenders who lend only through a licensed brokerage or a person who is exempt from being licensed as a brokerage, e.g., a credit union. On the other hand, lawyer exemptions in some jurisdictions have been restricted to activities within the scope of the lawyer's legal practice.

Questions:

1) *Do you have any recommendations regarding whether or not any type of entity should be exempt from registering under the MBA?*

2) *If an entity engaged in mortgage brokering activities were exempted from registration under the MBA, do you think that another aspect of the legislation should continue to apply to the exempt entity? If so, what aspect of the legislation do you think should continue to apply?*

F. The *Business Practices and Consumer Protection Act* and the MBA

On July 1, 2006, as part of a Canadian harmonization initiative, new cost of borrowing disclosure and conduct rules were brought into force under the *Business Practices and Consumer Protection Act* (BPCPA). At the same time, the cost of borrowing rules under the MBA were repealed, but the Registrar was given the power to enforce BPCPA requirements, including cost of borrowing rules, under the MBA.

Some believe that the cost of credit rules under the BPCPA provide more effective consumer protection than the former rules under the MBA as the BPCPA rules apply to all consumer loans, not just mortgages that include a finder's fee. However, some stakeholders have indicated that they find it somewhat confusing to navigate between the two pieces of legislation. In contrast to BC and Alberta, Ontario and Saskatchewan have cost of credit rules in their mortgage broker legislation to specifically address brokered mortgages.

The BPCPA requires mortgage brokers and lenders to provide disclosure to individuals who borrow for primarily personal, family or household purposes, regardless of whether the broker or lender is charging additional fees or expenses. To give borrowers an opportunity to understand the costs associated with their mortgage, assess affordability and compare competitors' terms, the disclosure must be given at least two business days prior to the borrower incurring an obligation under a credit agreement unless the two day period is waived by the borrower. Although the BPCPA does not contain prescribed disclosure forms, notices or statements of account, it does prescribe the required content including information relating to cost, time frames, payments, advances, interest rates, non-interest finance charges and penalties.

Despite the Canadian harmonization initiative, some stakeholders suggest that the formula used to calculate the annual percentage rate of interest (APR) does not produce the same result under all legislation in all jurisdictions. Although comprehensive negotiations took place between the provinces and the federal government to harmonize a template for calculating APR, each jurisdiction adapted the template differently to fit their legislative norms which has led to differences in wording amongst jurisdictions. For example, the wording in the federal *Bank Act* is different than

the BPCPA wording, although the rules under both statutes are intended to produce the same numerical result, within a prescribed margin of error.

Questions:

1) *Do you have any concerns with the cost of borrowing and conduct rules under the BPCPA? Do you have any suggestions on how to improve cost of borrowing disclosure requirements?*
2) *Do you have any suggestions on how the inter-relationship between the MBA and BPCPA could be presented more clearly?*
3) *Have you experienced any circumstances in which the cost of borrowing and disclosure rules under BC's BPCPA produce a different result, within the margin of error, or obligation than under Alberta's Fair Trading Act or federal or other provincial legislation? If so, have those differences caused you to incur additional cost or time?*

G. The *Securities Act* and the MBA

Since the late 1980's, the mortgage investment market has become increasingly complex, attracting both sophisticated and unsophisticated investors. Because mortgages sold as investments are generally securities within the meaning of the *Securities Act*, both the MBA and *Securities Act* can apply to a person registered as a mortgage broker under the MBA.

The intent underlying the *Securities Act* is to protect investors and support fair capital markets by regulating companies, firms or individuals that issue, trade or provide advice on securities. To assist investors, companies offering securities for sale must generally file a prospectus and meet extensive continuous disclosure requirements unless an exemption exists. In addition, firms and individuals trading or advising on securities must be registered in the relevant category of registration unless an exemption exists.

Before 2000, to reduce regulatory overlap, mortgage brokers who sold investments in mortgages, including syndicated mortgages in which two or more investors participate as lenders in one debt obligation, were exempt from registration and disclosure requirements under the *Securities Act* as they were regulated under the MBA.

The discovery of the Eron Mortgage fraud in 1997 exposed gaps in this regulatory system, particularly with respect to syndicated mortgages. To address these gaps, in 2000 the government and the British Columbia Securities Commission (BCSC) narrowed the registration exemption under the *Securities Act* to mortgage brokers selling non-syndicated mortgages or qualified syndicated mortgages on residential property with no more than four dwelling units. Mortgage brokers who wished to continue trading in syndicated mortgages had to become registered as investment dealers under the *Securities Act* and provide investors with a prospectus, unless the mortgage broker and issuer fit within any of the other registration and prospectus exemptions.

Exempt Securities Market Rules

In September 2009, the BCSC and other Canadian Securities Administrators implemented National Instrument (NI) 31-103, *Registration Requirements and Exemptions*. NI 31-103 streamlined, harmonized and modernized registration requirements and exemptions across Canada and created new registration requirements for investment fund managers and for exempt market dealers (EMDs) who sell prospectus-exempt securities (e.g. securities issued pursuant to offering memorandum, accredited investor, minimum investment, and family, friends and business associates exemptions).

All Canadian jurisdictions adopted NI 31-103 and the EMD registration category. However, the "northwestern" jurisdictions (BC, Alberta, Saskatchewan, Manitoba and the territories) made local blanket exemption orders (the "northwest exemption") to enable persons within those jurisdictions to continue using the capital raising registration exemptions that existed before September 2009 on meeting certain conditions including not having access to investor assets, not giving investor suitability advice, providing a prescribed risk acknowledgement form to the investor and filing exempt distribution reports electronically within 10 days of a distribution.

In addition, persons exempt from registration requirements under the northwestern exemption are not permitted to rely on it if they distribute east of the northwestern jurisdictions or if they are required to register in any other category of registration under the Securities Act including the new "investment fund manager" category.

In March, 2012, after finding that some of the worst investor experiences happened at the hands of former *Securities Act* registrants and others who had provided a financial service to the investor the BCSC made changes to the northwestern exemption to prevent those persons from relying on it to sell prospectus-exempt securities. This condition also exists in the other northwestern exemptions but extends only to former registrants and financial services providers who are providing a service to a previous client.

At the same time, amendments to the MBA imposed new conflicts of interest and investment disclosure requirements on mortgage brokers who dealt in simple loans and qualified syndicated mortgages.

Since 2000 other exemptions under the *Securities Act* have been expanded, permitting mortgage brokers, as well as other persons selling exempt market securities, to continue raising capital without being registered under that Act. The practice in the mortgage broker industry has also, in part, moved away from selling direct interests in syndicated mortgages as the scope of other *Securities Act* exemptions was expanded. In particular, Mortgage Investment Corporations (MICs) that own mortgage assets and issue shares in the MIC to the public have become popular investment vehicles and an important source of financing for borrowers and real estate developers.

Recently there has been a push for the BCSC to tighten the exemptions under the *Securities Act* (see "Exempt Securities Market Rules" above). However, in recognition of the importance of the real estate sector to the economy and the potential disruption that registration under the *Securities Act* could cause to MIEs, the BCSC extended the expiry date of BCI 32-517 - *Exemption from Dealer Registration Requirement for Trades in Securities of Mortgage Investment Entities* until June 30, 2013. The extension permits MICs and mortgage syndicators (together mortgage investment entities (MIEs)) to continue selling prospectus-exempt mortgage securities without being a registrant on meeting certain conditions that are similar to those that existed in the northwest exemption before March 2012. Until the expiry date of BCI 32-517, the BCSC will further analyze the extent and nature of the MIE marketplace in BC.

Without an exemption, MIEs are subject to the dealer registration regime, including know your client and suitability requirements relating to:

- the general investment needs and objectives of their client and any other factors necessary for them to be able to determine whether a proposed purchase or sale is suitable (know your client or KYC); and
- the attributes and associated risks of the products they are recommending to clients (commonly referred to as know your product or KYP).

Some people have suggested that the expansion of *Securities Act* exemptions and the division of responsibilities between the MBA and the *Securities Act* have not proven to be satisfactory and exposes consumers to unnecessary risk in the context of mortgage related investments. For example, a MIE or other issuer selling shares to a family member, close friend or close business associate of the principal does not have to provide offering memorandum disclosure document to the purchaser. As well, although a MIE must be registered under the MBA due to its mortgage lending activities, the

Registrar has no authority to regulate any aspect of the capital raising activities of the MIE since investors buy shares in the MIE and not mortgages. On the other hand, regulatory overlap is generally not desired since it can increase regulatory burden and blur lines of transparency and accountability.

Questions:

1) *If mortgage brokers registered under the MBA also participate in capital raising activities, to what extent, if at all, do you think they should be exempt from the Securities Act either in respect of registration or prospectus requirements?*
2) *Do you think any exemptions should depend on whether the MIE is selling direct interests in mortgages or shares in a MIC?*
3) *Do you think any exemptions in relation to selling direct interests in mortgages should depend on the type of mortgage being offered? For example, do you think the current rules that restrict exemptions to the sale of "qualified syndicated mortgages" are appropriate?*
4) *To what extent does the regulatory overlap created by the MBA and Securities Act place an undesirable burden on MIEs? What risk posed to borrowers and investors would be associated with reducing the overlap?*
5) *Do you think mortgage brokers selling shares in MICs or fractional interests in syndicated mortgages pursuant to Securities Act exemptions should be subject to know your client and suitability rules?*
6) *Do you have any other suggestions for regulating capital raising activities of mortgage brokers under the MBA?*

H. Licensing mortgage brokers

Currently, mortgage brokers are "registered" under the MBA. Some industry participants believe that "registration" implies a lower standard of regulation and that mortgage brokers and submortgage brokers should be required to be "licensed" because a license is perceived to bar unqualified persons from entry into the profession and ensure that the public will not be harmed by the incompetence of the individual. Other jurisdictions, including Alberta, Ontario and Saskatchewan, already require that mortgage brokers be licensed.

However, others feel that the term "license" and "registration" are synonymous and require the same or comparable standard of regulation. An example of "registration"

where a high standard of regulation can be illustrated is a securities dealer registered under the *Securities Act.*

Questions:

1) *Would you prefer mortgage brokers to be licensed or registered under the MBA?*
2) *Do you believe mortgage brokers would be held to a higher standard of conduct if licensing rather than registration were required?*

I. Educational Requirements

Individuals applying for registration under the MBA must successfully complete certain educational courses specified by the Registrar. After completing the courses individuals must apply for registration within one year of writing the exam to ensure their education is current.

Individuals who have significant experience in the mortgage broker industry may be able to enrol in an accelerated challenge program. This allows individuals to obtain the course materials and challenge the final exam without completing assignments.

The *Financial Institutions Act* and the RESA establish tiered and continuing education models. An individual applying for certain categories of licenses under these statutes must successfully complete additional educational courses and exams in order to become licensed at a higher level. In some cases, certain experience as well as education is required in order to obtain a particular licence. For example, an individual applying for a level 2 insurance adjuster licence must have two years licensed adjusting experience and must have successfully completed the approved course and exam. As well, there are ongoing educational requirements. For example, in order to have a real estate licence renewed, real estate services licensees must complete applicable continuing education courses and exams in relation to the real estate services and level of licence they are renewing.

There is no continuing education requirement expressly established under the MBA. However, the regulations are broad enough to permit the Registrar to require the completion of courses in order to renew a registration, and in May 2010 the Registrar launched a new relicencing education program administered by the Mortgage Brokers Institute of British Columbia (MBIBC).

Questions:

1) *If different classes of registrants are established under the MBA, do you think courses and exams should be developed specific to a class of registrants?*
2) *Do you think that experience and/or education should be used to determine if an individual is qualified to obtain a particular class of registration, e.g. mortgage administrator?*
3) *Do you think that continuing education courses should be mandatory to ensure that registrants remain current on regulatory requirements?*

Trust fund requirements

Currently, the MBA Regulations require mortgage brokers to keep and maintain trust records.

The RESA, which governs the licensing and regulation of real estate services providers, not only covers keeping trust account records but also how the trust funds must be handled, including maintenance of trust accounts, payments and withdrawals, interest and other issues. Mortgage broker legislation in Alberta, Ontario and Saskatchewan describes the types of money that are deemed trust funds, specify time frames for depositing money into the trust account, prescribe the type of financial institution where a trust account must be maintained and impose other administration requirements.

Although mortgage brokers usually handle mortgage trust funds appropriately, legislating requirements would help ensure that trust money is accounted for in the same manner by all mortgage brokers and may, promote transparency and facilitate audits.

Questions:

1) *What concerns, if any, would you have if the MBA prescribed the way in which brokerages handle trust funds?*
2) *What suggestions do you have for how trust funds should be handled?*

Insurance

Errors and omissions insurance is not currently required under the MBA. Many other professionals, such as insurance agents and real estate brokers, are required to have

errors and omissions insurance to ensure funds are available to pay for consumer losses caused by the agent's negligence in providing professional services.

Alberta and Quebec have made errors and omissions insurance a mandatory requirement for mortgage brokers. They also require their registrants to carry insurance to protect consumers and investors from dishonest acts on the part of mortgage brokers. In addition, Ontario legislation requires that brokerages have insurance or some other form of financial guarantee for errors and omissions with extended additional coverage for fraud. Alberta mortgage brokers are also covered by the Real Estate Council's assurance fund.

Questions:

1) *What are your views on requiring mortgage brokers to obtain errors and omissions insurance?*
2) *What are your views on requiring mortgage brokers to contribute into an assurance fund for the victims of mortgage fraud?*
3) *If you think errors and omissions insurance should be required, do you also think that additional coverage for fraudulent acts should also be mandatory?*
4) *If insurance is required, what is the appropriate minimum amount of coverage: $500,000, $750,000, $1 million, or some other amount?*

Personal service corporations

On January 1, 2009 regulations were brought into force to allow real estate licensees under the RESA to form personal corporations, similar to other professionals such as dentists, accountants and lawyers. This allows real estate agents to take advantage of various tax planning options without compromising their duties as licensees or consumer protection.

The real estate regulations establish a dual licensing scheme in which the licence of the individual and the licence of the personal real estate corporation are co-dependent and reflect each other. Both licences must be issued (or amended) to show the similar licence level, category of real estate services to be provided, conditions and restrictions (if applicable) and real estate brokerage through which services are provided.

Although, the MBA does not provide this option to individuals employed as submortgage brokers, the government has received some requests to allow submortgage brokers to form personal corporations, to access the business advantages of incorporation, similar to other professionals, while maintaining protection of the public.

Questions:

1) *Should a regulatory framework be developed to provide submortgage brokers with the ability to incorporate?*
2) *If so, what would that regulatory framework look like?*

Enforcement

When the MBA was enacted in 1972, the likelihood of being prosecuted in provincial court deterred unregistered and inappropriate conduct. Since then, the MBA was amended to broaden the enforcement powers of the Registrar to take effective action against non-compliant mortgage brokers. Specifically, the Registrar is now able to

- levy administrative penalties of up to $50,000;
- issue cease and desist orders;
- issue orders requiring a person to take specified actions;
- enforce orders by filing them with the courts; and
- utilize prescribed remedies under the BPCPA.

Mortgage brokers and submortgage brokers are entitled to a hearing before these powers are enforced. Since the MBA does not currently prescribe the practices and procedures of a hearing, they are determined in accordance with common law principles. This is in contrast to other British Columbian consumer protection statutes, including the BPCPA*, Securities Act* and RESA.

Questions:

1) *Do you have any suggestions on ways to further improve enforcement powers and remedies?*
2) *Do you think that the Registrar should have the ability to issue "tickets" for minor contraventions of the MBA, similar to the enforcement powers that the Real Estate Council of British Columbia has under the RESA?*
3) *Given the significant monetary value of mortgages and the risk of fraud, do you think that the current $50,000 limit on the amount of administrative penalties is appropriate? If not, what do you suggest the limit should be?*
4) *Do you think that the MBA should prescribe hearing practices and procedures?*

5) *Do you think the Registrar should be able to compel employees of a federally-regulated institution, such as a bank, to appear at a hearing?*

Other Issues

In addition to the issues listed above, please submit other problems, gaps, inconsistencies or ambiguities that you believe exist in the MBA and any reforms you would like considered. As well, please describe any aspects of the MBA that you believe are working well and that you feel should be retained in the future.