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association of bc

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April 3, 2015

Service Nova Scotia
Business and Consumer Services
Consumer and Business Policy
PO Box 1003
Halifax, NS
B3J 2X1

Attn: Mark Coffin, Registrar of Mortgage Brokers

Re: Draft Mortgage Regulation Act Regulations - Consultation

On behalf of the Mortgage Brokers Association of BC (MBABC), I would like thank you for affording our association with an opportunity to make submissions concerning the proposed regulations of the Mortgage Regulations Act (MRA). The new legislation and proposed regulations appear to be well crafted and create a forward thinking licensing regime for mortgage brokers in Nova Scotia.

By way of background, the MBABC is a 25 year old professional association which represents mortgage brokers and many private mortgage lenders in British Columbia. Regulatory oversight of mortgage brokers in BC was implemented with the enactment of the BC *Mortgage Brokers Act* in 1972, which was at that time an innovative piece of legislation. The MBABC has therefore accumulated a considerable depth of knowledge of mortgage broker regulation and mortgage broker practice. We can offer the following comments for your consideration concerning Nova Scotia's proposed regulations.

Exemptions from Mortgage Broker Licensing – section 3 of the Regulations Respecting Exemptions

Sections 3 exempts financial institutions and their employees from the requirements to comply with the MRA, which includes the requirement to obtain licensing under the

MRA. In particular, section 3(e) exempts from licensing employees or representatives of exempted entities, when acting solely on behalf of the entity. This exemption would therefore appear to apply to bank employees or representatives who work on behalf of the bank to place mortgages with third party lenders. However, this exemption may be worded too broadly and exempt mortgage brokering activity that falls clearly under provincial jurisdiction – not federal and not under the *Bank Act*.

The *British North American Act* of 1867 (now called the *Constitution Act*, 1867) defines Canada's federal structure by determining the jurisdiction or areas of authority to be exercised by both the federal government and the individual provincial governments. The federal government has control over all matters not coming under provincial control, in addition to a list of specified areas, including "banking". While the provincial legislatures have jurisdiction over a list of specified areas which include property and civil rights. The property and civil rights powers have been broadly interpreted to provide the provinces with authority over professional trades and consumer protection issues. Mortgage broker regulation is therefore a provincial matter by virtue of the provinces power to regulate matters relating to property and civil rights within their provincial borders.

"Banking" is not the same as "bank business", and in many cases banks are engaging in non-banking bank business that falls within provincial jurisdiction, such as selling insurance or mutual funds. Another example would be that of mortgage brokering. Bank mortgage brokering occurs where the bank employee does not facilitate a loan with the bank, but rather brokers a mortgage deal with a third party lender, such as a trust company, mortgage investment corporation or other private lender. In addition, we are of the view that bank mortgage brokering includes dealing in mortgages under a name other than the proper name of the bank, and bank employees representing themselves to the public as mortgage brokers or mortgage advisors.

The Supreme Court of Canada has just rendered a long awaited and ground breaking decision which provides guidance on this issue. In the case of *Bank of Montreal v. Real Marcott* (and two other cases), a class action suit was brought against the bank for failing to disclose exchange fees on credit cards as credit charges, as required by Quebec consumer protection legislation. The bank argued that the Canadian constitution gave the federal parliament exclusive jurisdiction to regulate banks. However, the court decided that Quebec's consumer protection legislation is "constitutionally applicable and operative" to banks.

We can easily apply the principles set out by the Supreme Court in *Marcott* to the case of bank brokering, and conclude that exemptions from mortgage broker licensing for bank employees, who arrange third party mortgages, are unconstitutional. It puts control over bank brokering within federal control, and thereby infringes on an area of provincial jurisdiction.

We therefore recommend that you clarify the proposed exemption for banks and their employees by ensuring that the exemption does not apply to the following:

- The act of brokering mortgages for borrowers with third party lenders which are not the financial institution;
- Dealing in mortgages under a name which is not the proper name of the financial institution; and
- Employees of financial institutions who represent themselves as advisors or brokers.

Exemptions from Mortgage Broker Licensing – section 4 - Referrals

Section 4 exempts persons from the requirement for mortgage broker licensing if they are engaging in referral activity and satisfy the criteria laid out in these sections. Persons who make incidental mortgage referrals, such a realtor who recommends a mortgage broker to a purchaser, should not be captured by a requirement to obtain mortgage broker licensing. However, entities and individuals who actively solicit mortgage referrals as a business should not be exempt from mortgage broker licensing, and may be exempt given the wording of section 4.

Businesses which specialize in mortgage lead generation or providing mortgage referrals to brokers for a fee have exponentially proliferated over the last ten years. A bulletin (MB10-004) from the BC FICOM website describes mortgage lead generation as involving “an entity or individual gathering lists of potential mortgage borrowers, who are considered to be “mortgage leads”. The lists of mortgage leads are then sold to mortgage brokers, who may contact the individual leads for the purpose of attempting to arrange mortgage financing for them. The lists of potential mortgage borrowers are often generated through the internet by setting up a website which may provide mortgage information or mortgage advice and providing a simple form of mortgage application. The application data is gathered by the mortgage lead generator and then forwarded to the mortgage broker. Mortgage leads may also be generated over the telephone by telemarketers contacting persons and enquiring about their interest in obtaining a new mortgage or refinancing a current mortgage, in addition to gathering personal and financial information from the potential borrower.”

Mortgage lead generators or mortgage referral businesses often resemble mortgage brokers and lenders. In many cases, it is impossible for the public to differentiate them from a broker. We therefore recommend that section 4 be revised to ensure that individuals or entities which actively solicit mortgage referrals not be exempt from the requirement to obtain mortgage brokering licensing.

Regulations Respecting Licensing – Section 3 – Criminal Record Check

Section 3 (1) (and other like sections) make it a requirement that an applicant for licensing have no evidence on his or her criminal record check of any conviction for fraud or theft, and must not raise any issues concerning the appropriateness of issuing or renewing the license. Consideration to amending this section might be given to ensure that persons who have been convicted of fraud or theft are not completely prohibited from obtaining a license. Some persons with past convictions may have

mitigated either wholly or in part, the concerns related to a criminal record through the simple passage of time since the criminal incident, efforts to rehabilitate including course work and counselling, restitution or in other ways.

In addition, the reference to only convictions for fraud and theft appears to be quite limited. Would the Registrar not also have concerns with applicants who have been “charged” but not yet convicted of a criminal offence? The Registrar may also have concerns with applicants who have been convicted of other offences, such as crimes involving violence which pose a public safety concern (eg. murder, assault, threatening), drug trafficking, and a host of other offences under federal statutes or the criminal code which involve dishonesty.

Section 3(1) may not be necessary given the broad discretion afforded to the Registrar under the MRA to refuse to issue licences if not in the public interest. We therefore recommend that the Registrar exercise his discretion to issue a license in cases where the applicant has a record exclusively under the provisions of section 14 of the MRA, and that section 3(1) be deleted from the Regulations.

Regulations Respecting Licensing – Section 3 – non-compliance with the MRA

Section 3(1)(e) provides that with an application for renewal only, the applicant must be in compliance with the MRA. However, in some cases, applicants for an initial license may have previously engaged in activity requiring a license without being licensed, and hence are in violation of the MRA. Consideration might be given to broadening the scope this section to capture circumstances involving unlicensed activity by a new licensing applicant.

Regulations Respecting Licensing for Mortgage Brokerages – Section 11(1) Criminal Record Check

This section requires the officers of corporate mortgage brokerages to obtain a criminal record check. We suggest that you also require all of the directors of corporations to obtain criminal record checks, as the directors are ultimately responsible for the governance of the corporation. In addition, the partners in a partnership are likely to be corporations, and under section 11(1) it may not make sense to require a criminal record check on a corporate partner – but it would make sense to require a criminal record check on each director and officer of each corporate partner. This could be clarified in this section.

Phase 2 Regulations

Section 7 – Ensuring Cost of Borrowing Disclosure

This section requires a broker to ensure that the cost of borrowing disclosure has been provided to the borrower by or on behalf of the mortgage lender. It is not clear then if

the broker has an obligation to deliver the Cost of Borrowing Disclosure in the event that the lender fails to do this or if the primary obligation to deliver the disclosure rests with the lender and not the broker. These obligations could be clarified in this section.

Form 1 Mortgage Disclosure Form and Form 2 Mortgage Brokerage Recommendations and Assessment

These disclosure forms appear to envision that the mortgage broker will provide various mortgage options for the borrower. Generally, mortgage brokers are knowledgeable about the best lender options for a particular borrower, and will submit the mortgage application to the best potential lender, one at a time. Mortgage brokers do not generally find success in shopping a mortgage application to a multitude of lenders at the same time. This is an inefficient process that is likely to cause lenders to pass on the mortgage application, and provide poorer results for the borrower. We recommend that you amend the Form 1 accordingly, and remove the Form 2 altogether. Significant elements of the mortgage proposal to the borrower should simply be incorporated in the Cost of Borrowing form. This makes disclosure simpler, and simpler disclosure for borrowers will be more effective. Mortgage borrowers are unlikely to read and fully comprehend details when there are too many forms containing similar information.

Cost of Borrowing - Definition of "disclosure statement"

The definition of disclosure statement makes it clear that the lender provides the disclosure statement to the borrower. However, certain costs of the mortgage will not be known by the lender. Borrowers may owe specific costs, fees or other expenses to the mortgage broker. Unbeknownst to the lender, the borrower may have a contract with the broker to pay a broker fee or to compensate the broker for expenses, such as a appraisal. There would need to be an obligation on the lender to investigate these potential additional costs with the broker. Many lenders would find this investigation process inefficient. This is why in BC, the primary obligation to prepare and deliver cost of borrowing disclosure is on the broker and not the lender. We therefore recommend that cost of borrowing disclosure be provided by mortgage brokers and not mortgage lenders where there are additional costs charged by the broker.

Cost of Borrowing - Section 3(2)(a) (b) Corporations and Business Purposes

This section makes mortgage loans for corporate borrowers and for business purposes exempt from the requirement to provide cost of borrowing disclosure.

It is not clear if cost of borrower disclosure must be provided under the following scenarios:

- The primary borrower is a corporation and a secondary borrower or guarantor is a natural person – it is not clear if exposing a natural person to any liability under the mortgage is sufficient to trigger the requirement to provide disclosure.

- The mortgage loan is used to finance the purchase of a single family home, but the purchaser will or may rent it out to tenants on a temporary or permanent basis – is the mortgage loan for primarily personal or business purposes in this circumstance ?
- The mortgage loan is used to finance the purchase of a single family home, but the purchaser may improve it, and then resell it at a higher price to reflect the value of the improvements – is the mortgage loan for primarily personal or business purposes in this circumstance ?
- The mortgage loan is used to finance the purchase of a house with a basement suite, and the purchaser opts to rent out the upstairs portion and live in the basement until he or she can afford to live in the upstairs portion of the house – is the mortgage loan for primarily personal or business purposes in this circumstance ?

In some circumstances, if disclosure is not required to be provided to a borrower as it is for business purposes, a harsh result may ensue. For example, consider that the purpose of a mortgage loan is clearly for business purposes, but the mortgage is registered against the title of a business person's family home, and the person's spouse, who is registered on title as a joint tenant, has no interest in the business. The spouse will not take any direct benefit of the mortgage, but will be exposed to all of the liability of the mortgage. He or she will also not be entitled to any of the protections or benefits of obtaining a disclosure statement.

Similarly, if a mortgage loan is a refinance, and 55% of the proceeds are used for business purposes and 45% of the proceeds are used for personal needs, the borrower will not be entitled to any of the protections or benefits of obtaining a disclosure statement. It is not clear why a borrower should not be entitled to a disclosure statement if any of the mortgage proceeds are used for personal or household reasons.

Ironically, if a person were to mortgage his or her residence and use the proceeds of the mortgage for investment or business interests, they would also not be entitled to the benefit of a disclosure statement.

It may be simpler and better understood if the obligation to provide disclosure depended on the type of property being mortgaged, such as a residential property or a multifamily property containing three or less residential units. Redefining the obligation to provide disclosure on this basis would also better protect borrowers, including ones in the scenarios described above.

Cost of Borrowing - Section 4(b) Exemptions for Financial Institutions

This section exempts specific financial institutions from the obligation to provide cost of borrowing disclosure to borrowers, presumably because disclosure is provided by the financial institution to the borrower. However, as stated earlier, borrowers may owe

specific costs, fees or other expenses to the mortgage broker. Unbeknownst to the financial institution, the borrower may have a contract with the broker to pay a broker fee or to compensate the broker for expenses, such as a survey. This provides a potentially significant underestimation of the APR value, which will in some cases exceed the error tolerance value of 1/8th of a percent. We therefore recommend that cost of borrowing disclosure be provided by mortgage brokers in circumstances where there are additional costs not disclosed in the disclosure statement provided by the financial institution.

Section 6(1) - Calculation of the APR

The APR is calculated according to the following formula:

$$APR = \frac{(100 \times C)}{(T \times P)} \quad \text{where C is the cost of credit, T is the term and P is the average outstanding principal over the term.}$$

This formula does not work with mortgages where the compounding rate does not match the payment frequency. This is a problem as most mortgages have interest which is compounded on a semi-annual basis and monthly payments. If there are no non-interest finance charges, the formula when applied correctly should result in an APR which is exactly equal to the contractual interest rate. However, the formula does not work and can produce a discrepancy between the contractual interest rate and the APR which even exceeds the permitted error tolerance rate of 1/8 of 1% or .125%, which is set out in section 4 of the Regulation. See the example below.

Mortgage Amount:	\$100,000.00	Term:	1 year
Interest Rate:	8.00%	Amortization:	25 years
Payments made:	Monthly of \$763.21	Compounded:	Semi-annual

Payment #	Date	Interest	Principal	Balance	Total Interest
1	02/18/2015	655.82	107.39	99,892.61	655.82
2	03/18/2015	655.12	108.09	99,784.52	1,310.94
3	04/18/2015	654.41	108.80	99,675.72	1,965.35
4	05/18/2015	653.69	109.52	99,566.20	2,619.04
5	06/18/2015	652.97	110.24	99,455.96	3,272.01
6	07/18/2015	652.25	110.96	99,345.00	3,924.26
7	08/18/2015	651.52	111.69	99,233.31	4,575.78
8	09/18/2015	650.79	112.42	99,120.89	5,226.57
9	10/18/2015	650.05	113.16	99,007.73	5,876.62
10	11/18/2015	649.31	113.90	98,893.83	6,525.93
11	12/18/2015	648.57	114.64	98,779.19	7,174.50
12	01/18/2016	647.81	115.40	98,663.79	7,822.31
Grand Total:		7,822.31	1,336.21		
Average Bal:				99,396.23	

$$\text{APR } \frac{100 \times 7,822.31}{1 \times 99,396.23} = 7.87\%$$

The APR is 7.87%, which is .130 % lower than the contractual rate of interest, despite there being no non-interest finance charges. This error exceeds the tolerance rate of .125% and the statement set out in section 6(1) may therefore not always be true.

Section 7 - Costs to be included in the APR value

In some circumstances, brokerage fees are paid directly by the borrower to the lender, and should be included in the list of costs to be incorporated into the APR.

In some circumstances, the lender requires the borrower to incur legal fees which are paid by the borrower and not the lender, and should be included in the list of costs incorporated into the APR.

Section 20 - Default Charges

This section permits the lender to recover legal costs and expenses from a delinquent borrower. However, if a mortgage delinquency results in court action, the court may determine the amount of costs which the lender can recover from the borrower, and awarded court costs are in general a fraction of the amount of real legal expenses paid. We therefore recommend that section 20 be amended accordingly.

Section 21 - Advertising Interest Rates

Most mortgage brokers will advertise the interest rates which are commonly available from prime lenders, where there are usually very limited non-interest finance costs, resulting in an APR that is equivalent to the contractual interest rate. In these circumstances, it does not appear necessary to include the APR with the advertised rate, and we would recommend only requiring disclosure of the APR where the APR would be different from the contractual interest rate.

Advance Fees/Application Fees

The wording on the proposed Form 2 appears to contemplate that application or advance fees are permitted to be charged to residential borrowers. We would recommend some limits on charging advance or application fees for residential mortgages. The purpose of any prohibition against taking advance fees is to prevent advance fee fraud, wherein a fraudster will promise to loan money in return for an upfront fee. The fraudster then pockets the advance fee with no intention of funding the loan. There may also be circumstances where brokers or lenders charge fees to unwitting borrowers who stand no chance of success with a mortgage application, and the ability to charge advance fees can lead to abuse. Limits on the application and

advance fees for residential mortgages are therefore an important public protection measure.

We would suggest a balanced approach to the issue of advance fees which takes into account the mortgage broker's or lender's right to be compensated for valuable service provided to the public. The challenge for many mortgage brokers is that they may be reluctant to take on difficult mortgage clients, when their fee is contingent on their application actually being approved and funded. Often mortgage files require many hours of preparation, document management and negotiation. Sometimes mortgage commitments are obtained by mortgage brokers after they have invested significant amounts of time into the file, but the client will eventually opt for alternative financing or decline the offered financing – this can happen even at the last minute, just prior to closing .

Most professionals, including lawyers, accountants and realtors are able by contract to negotiate advance fees. Lawyers, for example, commonly ask for a retainer of funds from a client, which are kept in their trust account and withdrawn only when the services and an account have been rendered.

In Ontario, the Regulations to the *Mortgage Brokerages, Lenders and Administrators Act* provide that “If the principal amount of a mortgage is \$300,000 or less, a brokerage shall not require a borrower to make, and shall not accept, an advance payment or deposit for services to be rendered or expenses to be incurred by the brokerage or any other person.” Advance fees are therefore permitted to be charged by mortgage brokers in Ontario for residential mortgages with a principal sum of over \$300,000.

In Alberta, section 71 of the *Real Estate Act* Rules places restrictions on the collection of an advance fee for assisting an individual in obtaining a mortgage from a lender. This rule applies to a mortgage where the borrower is an individual who enters into a credit arrangement primarily for personal, family or household purposes. It prohibits collecting a fee from such an individual until the lender has provided written confirmation to fund the mortgage to the borrower, has provided an initial disclosure statement and at least two business days have passed since the disclosure statement was received (or the individual has waived the time period for its delivery in accordance with the *Fair Trading Act*). In Alberta then, mortgage brokers are entitled to charge fees in advance of mortgage funding if a mortgage commitment has been obtained and cost of credit disclosure rules are followed.

We suggest that Alberta has the most balance approach to setting limits on the charging of advance fees, and Nova Scotia may wish to consider adopting this approach. We would not recommend any limits on the charging of costs paid to third parties in the mortgage approval process, eg. reimbursement to mortgage brokers who have paid appraisal costs, or any limits for commercial mortgages.

Thank you again for the opportunity to provide comments on the proposed MRA regulations. If you wish to discuss this matter further, please contact me.

Yours truly,

THE MORTGAGE BROKERS ASSOC. OF BC

A handwritten signature in black ink, appearing to read 'S. Gale', written in a cursive style.

Samantha Gale, CEO