

Consultation Paper: Mortgage Brokerage – Proposed Standards of Practice and Rule Changes

The Real Estate Council of Alberta (RECA) acknowledges that self-regulation is a privilege. Other jurisdictions in Canada have experienced increased government scrutiny and, in the case of British Columbia's real estate industry, have lost the privilege of self-regulation. As a proactive regulator, RECA makes every effort to continually enhance its regulation of the industry, and ensure consumer protection remains at the core of its work.

The Mortgage Broker Regulators' Council of Canada (MBRCC) and RECA's Mortgage Brokers' Advisory Committee (MBAC) researched disclosure rules across the country, along with documentation practices, service relationships with borrowers and lenders, and borrower information verification processes. Following that research, MBAC made a number of recommendations to Council for revised standards of practice and Rule changes.

Council directed RECA Administration to consult with stakeholders on these important topics. Council wants to ensure that Alberta's rules and standards of practice are strong, and that they continue to provide appropriate consumer protection. RECA wants to know if there are ways in which it can and should enhance consumer protection in a number of areas, while recognizing the needs of mortgage brokerage professionals.

This consultation paper asks stakeholders for input on:

1. Disclosures of material risk and product suitability to consumers
2. Removal of intermediary relationship option
3. Document and Information Verification: Mortgage Fraud
4. Private lending procedures

Stakeholders can provide their feedback on these proposals through an [online survey](#). We strongly encourage all stakeholders to review the complete consultation paper before providing their feedback. Please provide your feedback on or before May 8, 2018.

Background

Reasons for Change

There are five primary reasons (trends) why RECA is exploring ways to enhance consumer protection:

- 1) **conflict of interest disclosure rule changes in British Columbia:** the mortgage broker regulator in B.C. introduced enhanced rule changes

for its licensees regarding conflict of interest disclosure as it relates to compensation. RECA does not believe that particular approach provides added value to consumers and believes appropriate compensation disclosure rules are already in place, it prompted RECA to consider its disclosure rules as a whole.

- 2) **the threat of the loss of self-regulation:** this remains an ongoing issue for all self-regulatory bodies in Canada (and globally). Increased scrutiny from governments, licensees, media, and consumers means regulatory bodies need to remain focused on consumer protection, continual enhancement of that protection, and right-touch regulation.
- 3) **harmonization with the practices in other provinces:** as a member of the Mortgage Broker Regulators Council of Canada (MBRCC), and as a result of the Canadian Free Trade Agreement, RECA is committed to harmonizing its regulatory practices, when possible and practical, with other provincial mortgage broker regulators. With respect to product suitability, Ontario and Saskatchewan currently have standards in place that Alberta does not
- 4) **private lending rules:** new federal mortgage rules have also caused an increase in private lenders entering the market. These lenders fill the void left by traditional lenders. The rules regulating private lending in Alberta are old, and many mortgage brokerages professionals may not have any experience dealing with private investor/lenders. Given this trend, inexperienced private investor/lenders may be reaching out to mortgage brokerage professionals who do not have much experience in this side of the business. MBAC believes we need to tighten rules for consumer protection, and to enhance the disclosure of information to private investor/lenders. This will also help ensure consistent standards of practice across the industry as brokerages that specialize in this area have developed higher levels of risk disclosure and product suitability measures, but other brokerages have not.
- 5) **consumer-driven mortgage fraud:** New mortgage rules set by the federal government have made it more difficult for consumers to obtain mortgages, and as a result, we've seen an increase in consumer-driven mortgage fraud, where consumers misrepresent information in their application such as assets, income, or employment status in the interest of being approved for their mortgage.

How we got here

Based on input from industry members, MBRCC, and other stakeholders during RECA's strategic planning sessions in 2016, the MBAC identified the trends listed above, and began to think about changes to policies and rules that can help RECA effectively deal with these trends.

- October 2016: MBAC asked RECA Administration to develop new disclosure documents for mortgage brokerage professionals

- May 2017: MBAC reviewed potential policy and rule changes, and the draft disclosure documents
- September 2017: MBAC recommended to Council that RECA Administration consult with stakeholders on proposed Rule amendments and documentation changes. Council approved that recommendation at its October 2017 meeting.

Consultation Topics

A. Disclosures of material risk and product suitability to consumers

Current situation: The current Rules require mortgage brokerage professionals to disclose their compensation. Additionally, there are Rules that require mortgage brokerage professionals to act honestly, provide competent service, fulfil their fiduciary obligations, and avoid and disclose any conflicts of interest that arise from their compensation.

The MBAC explored the new disclosure requirements in BC, but determined there are appropriate levels of compensation disclosure in Alberta under the existing Rules. However, the Committee believed it is still possible for mortgage brokers to provide additional value and protection from conflicts of interest for borrowers through required disclosures of material risks and product suitability. MBAC strongly believes that such disclosures, if required, would enhance consumer protection, and improve the services and value that mortgage brokerage professionals provide to borrowers.

Research shows that many Alberta mortgage brokerage professionals are often talking to borrowers about material risks and product suitability, but they are not documenting those discussions, and it creates inconsistencies in the industry.

Proposed policies: Revise section 65 of the *Real Estate Act* Rules to require mortgage brokerages to disclose in writing, and seek written confirmation from the borrower, of the material risks of the borrower's mortgage using a new consumer-oriented form, [Understanding Your Mortgage Material Risks](#), with mandatory content.

Additionally, revise section 65 of the Rules to require mortgage brokerages to:

- disclose in writing a suitable mortgage for a borrower and the reason for the decision
- seek written confirmation from the borrower using a [Mortgage Product Suitability Disclosure document](#) that contains mandatory content.

Questions:

1. Do you currently discuss the material risks from the [Understanding Your Mortgage Material Risks](#) form with borrowers?
2. Is there anything missing from this [list of material risks](#)?
3. Do you currently discuss the information within the [Mortgage Product Suitability Disclosure document](#) with borrowers?
4. Is there anything missing from the draft [Mortgage Product Suitability Disclosure document](#)?
5. Are there additional tools (checklists, brochures, etc.) you would like RECA to provide to assist you in discussing material risks and product suitability with borrowers?

B. Removal of intermediary relationship option

Current situation: If there is a new requirement to disclose a suitable mortgage product to the borrower, it creates a fiduciary relationship between that borrower and the mortgage broker. If RECA implements required disclosures of material risks and product suitability as detailed in Section 1, it will eliminate the opportunity to have an intermediary relationship between a mortgage brokerage and borrower. Mortgage brokerages would have to represent the borrower except in the case where the mortgage brokerage is representing a private investor/lender. However, the mortgage brokerage may represent the borrower where another brokerage represents the private investor/lender in the same transaction.

Proposed policy: MBAC recommends the elimination of intermediary relationship status. Removing intermediary relationship status would therefore require a mortgage brokerage to represent the borrower unless the brokerage is representing a mortgage investment entity or an individual private investor/lender.

RECA would amend the Rules to create mandatory content within the following documents:

- SERVICE AGREEMENT - Acting for the borrower
- Borrower Disclosure & Consent - Acting for the lender

Questions:

1. Do you agree with removing intermediary relationship status?
 - a) Yes
 - b) No

Why?

2. Are there additional tools or resources RECA could provide that would help you represent borrowers following the removal of intermediary status?

C. Document and Information Verification: Mortgage Fraud

Current situation: Part of RECA's mandate, under section 5 of the *Real Estate Act*, is to detect and suppress mortgage fraud. The government of Alberta added this clause to the Act in 2006 as a result of rising mortgage fraud rates, and because of RECA's position in the industry as the regulator of real estate and mortgage brokerage professionals.

Currently, mortgage brokerages must disclose in writing what steps, if any, they have taken to verify the information contained in the mortgage application, but they are not required to verify the information.

Proposed policy: MBAC recommends changes to section 72 of the *Real Estate Act* Rules that would require mortgage brokers to take reasonable steps to determine the accuracy of information included in a mortgage application. Additionally, RECA would prepare a practice guide for mortgage origination focusing on detecting mortgage fraud. Included in the guide will be an [information verification checklist](#) with mandatory content, and an appendix that lists all tools and resources on RECA's website.

Questions:

1. Do you believe mortgage brokerage professionals have a role in suppressing mortgage fraud?
2. Do you agree that mortgage brokerage professionals should have an obligation to verify the information contained in a mortgage application?
3. Do you agree with the proposed policy, which would require mortgage brokerage professionals to take reasonable steps to determine the accuracy of information included in a mortgage application?
4. Do you believe that the steps outlined in this [document](#) are reasonable?
5. Do you have any suggestions for changes to the [checklist](#)?

D. Private Lending Procedures

Current situation: RECA does not believe there are appropriate Rules in place to regulate syndicated mortgages and the rules governing a single private investor/lender are inadequate. Consumers are at risk unless RECA implements an appropriate regulatory regime. The Real Estate Assurance Fund is also at risk for defaulting syndicated and private mortgages arranged by mortgage brokers. Victims of fraud or breach of trust relating to private lending and syndicated mortgages can look to the Fund for compensation, and this places individual industry professionals at risk of having to pay into the assurance fund. Strengthening the rules will clarify roles and responsibilities, and provide a consistent standard of practice within the industry

Furthermore, it is MBAC's belief that RECA does not have appropriate mortgage administration Rules in place.

Proposed policy: MBAC recommends that Council amend the *Real Estate Act* Rules to:

- include new requirements for mortgage brokers when representing lender clients
 - require Written Service Agreements between the mortgage brokerage and the investor/lender
 - Written Service Agreement to contain mandatory content, and some aspects of the proposed loan
 - duties to the investor/lender include underwriting, understanding the investor/lender's risk tolerances, and disclosure of risks
 - specific documents must be provided to the investor/lender
 - comply with the Cost of Credit Disclosure requirements under the *Fair Trading Act*
 - investor/lenders can waive some of the requirements, which will allow brokerages some flexibility when dealing with experienced investor/lenders
 - some requirements will not apply to entities in the business of making loans
 - Written Service Agreements will be required when a mortgage brokerage provides mortgage administration services for a private investor/lender
 - when providing mortgage administration services, a mortgage brokerage will have specific duties, such as providing statements, disbursing funds and periodic reporting requirements
 - there will be requirements for dealing in syndicated mortgages
 - specific reporting and agreements between participants when administering a syndicated mortgage

- o minimum E & O insurance coverage, and employee fraud coverage for those dealing in syndicated mortgages
- create a new Private Investor/Lender Mortgage Risk Disclosure Form with mandatory content to disclose to private investor/lenders the material risks of that loan (investment). The form will:
 - o identify the lender and the brokerage
 - o describe and acknowledge risks
 - o describe any conflicts created by related party involvement in the transaction
 - o identify other conflicts with the brokerage
 - o provide the details of
 - property
 - mortgage terms
 - borrower information
 - o describe the documents provided
 - o include signatures
- create a new Client Application Details form with mandatory content to ensure the mortgage brokerage knows its client and determines the suitability of the mortgage investment for the private investor/lender. The form to include:
 - o lender personal information
 - o declaration for exemption from the suitability test based on net worth or having a qualified advisor
 - o assets/liabilities of the investor/lender
 - o investment needs, objectives, risk tolerances, knowledge of this type of investment
 - o Accredited Investor exemption if applicable
 - o anti-money laundering questions
 - o disclosure regarding the use of borrowed money to make the loan/investment
 - o privacy disclosure
 - o signatures
 - o definitions

Questions:

1. How do these proposed requirements compare to your current practices?
2. Do you have further suggestions for Rule changes or mandatory form content that will further enhance consumer protection?

E. Closing Comments

1. Do you have any additional comments for Council to consider with respect to the topics within this consultation paper?

What next?

In addition to this consultation paper and the questions within it, there are other opportunities for industry members and related stakeholders to provide their feedback on these important topics. Stakeholders are encouraged to provide their feedback via an [online survey](#), which contains the questions from this paper.

RECA will be holding town hall-style information sessions in Calgary and Edmonton to engage with mortgage brokerage professionals in person on these topics. Watch for an email from RECA with invitations to those sessions.

This formal consultation will end on May 8, 2018, and following that, Council will review the feedback and will determine its next steps, which could include a second consultation. Council will determine whether to hold a follow-up consultation based on the feedback it receives during this current consultation initiative.

Please continue to watch for updates via RECA News emails and via the April and July 2018 Regulator newsletters.