October 9, 2015

The Mortgage Brokers Association of British Columbia

comments to

The Registrar of Mortgage Brokers

regarding

The Registrar's Proposal to Amend the Form 10 to Require the Disclosure of the Amount of Fees Paid to Mortgage Brokers by Lenders

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The MBABC received an email communication from the Deputy Registrar in June of this year advising that the Registrar intended to amend the Form 10, Conflict of Interest Disclosure Statement by requiring brokers to disclose lender compensation figures to mortgage borrowers. Upon receiving questions from our members about this issue, we advised the Registrar that we intended to make submissions on the merits of the proposed change.

Before we provide our submissions regarding the substance of the proposed changes, we feel compelled to convey concerns expressed by our members. The sentiment is that government should consider changes such as the ones proposed openly and transparently. As well, the process should include proper consultation from stakeholders (properly representative stakeholders where full consultation is not practical). The need for the change and the legal authority for making the change should be made evident. Members have expressed concern that this has not been done in this case.

On September 30, 2015 we were invited to make submissions on the matter by October 9, 2015. It was not until October 8, 2015 that legal counsel for the Registrar advised us of the legal foundation on which they were basing the changes. This was after the Deputy Registrar responded to our inquiry for the legal foundation by referring us to counsel. We thank the Registrar for the opportunity to make submissions and have strived to be as complete and thorough as the tight timeline has allowed.

Our primary submissions are that:

- the Registrar does not have the power to make the intended changes
- if the Registrar did have the power to make the intended changes, the proposed changes are not warranted
- the common law already requires disclosure of the amount of the fee in situations where the broker is a fiduciary of the client
- detailed compensation disclosure fails to benefit and actually harms mortgage consumers

We make the following comments to support these four submissions.

Lack of Authority

The Registrar seeks to change the substance of the requirement concerning fee disclosure to require all brokers, including non-fiduciaries, to disclose not only that the lender is paying a fee to the broker but to disclose the quantum of the fee.

In support of this new requirement the Registrar (through legal counsel) explained, *“XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX*

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Section 17.3 of the Mortgage Brokers Act (MBA) does not provide authority for the Registrar to make the proposed changes. Section 17.3 provides:

> (1) Every mortgage broker who acts in a mortgage transaction in which there is an interest as described in subsection (2) (a) must, within the prescribed time, provide to every person who is a borrower under a mortgage in that transaction a written disclosure statement that meets the requirements of subsection (2).
>
> (2) The disclosure statement referred to in subsection (1) must
>
> > (a) disclose any direct or indirect interest the mortgage broker or any associate or related party of the mortgage broker has or may acquire in the transaction,
> >
> > (b) include the prescribed contents and be accompanied by any documents that are prescribed,
> >
> > (c) be dated and signed by the mortgage broker, and
> >
> > (d) contain disclosure that is true, plain and not misleading of the matters in the prescribed contents referred to in paragraph (b).

There is no question section 17.3 contains flawed drafting. For instance, the obligation to provide disclosure falls onto the mortgage broker and not the submortgage broker, which is a practical impossibility given that clients interact and deal with individual submortgage brokers and not mortgage broker entities.

Of note is that the British Columbia Supreme Court in *Registrar of Mortgage Brokers v. Financial Services Tribunal and Matick* ruled that the Registrar cannot fill in any gaps where section 17.3 contains inconsistencies, gaps or incomplete requirements. In paragraphs 35 and 36 the Court determined:

> *[35] As for the correct interpretation of the words, there is a difference of intention expressed as between them on a plain reading of s.17.3. The section provides for a mortgage broker but not a submortgage broker to disclose its associates. In my view, the legislature despite the seeming inconsistency has*

> *definitely placed the legal disclosure requirement in s. 17.3 only upon mortgage brokers and not upon submortgage brokers. It is not a gap to be filled under the power of the Registrar.*
>
> *[36]   I find that s. 17.3 of the **Act** does not apply to a "submortgage broker". The Tribunal's ruling of a breach of s. 17.3 is quashed.*

The Court in the case was cognizant of the fact the Registrar is a creature of statute and has only those powers granted to it by its creating statute. Almost all of the regulation-making powers under the MBA are, pursuant to s.23, given not to the Registrar but rather to the Lieutenant Governor in Council. The very limited regulation-making powers of the Registrar are provided in s.24 in the following terms:

> *The registrar may permit variations from forms prescribed under this Act if, in the registrar's opinion, to do so would not be contrary to the public interest.*

The power is clearly one concerning the changing of forms, in limited circumstances and not a power to make changes of substance. The proposed changes would undoubtedly be changes of substances and not mere form.

In summary, the regulation making power of the Registrar is to vary prescribed forms, not the substance of the forms. The proposed change would very much be a change in substance and not merely a change in form. There is nothing in s.17.3 which requires a broker to disclose the amount of the fee. To the degree the Registrar sees this as a gap, the Registrar is without authority to fill it. In any event, s.17.3 applies only to mortgage brokers and not to submortgage brokers.

Changes are not Warranted

Section 17.3, in the very limited scope it is applicable, is a mandatory compliance provision. This is due to the use of the word "must" in the provision.

Mortgage brokers have been complying with this section since the introduction of the Form 10 in the year 2000 by disclosing that they earn fees from lenders. This particular form of disclosure has been pursuant to the Registrar's guidance on compliance for mortgage brokers over the course of the last 15 years.

The Registrar has not pointed to new or additional factors (such as court rulings) having intervened to mandate a change in direction regarding disclosure requirements. To change the form at this stage would put the Registrar in the unenviable position of indicating her office erred for over 15 years in providing mortgage brokers with guidance in complying with (perhaps more accurately, not complying with) a mandatory regulatory provision.

That said, it is our position that the proposed change is inherently wrong and mortgage brokers are complying with section 17.3 and providing meaningful disclosure by explaining that they earn lender fees to borrowers. There is nothing in section 17.3 which states that disclosed interests have to be further defined by quantum or other similar numerical descriptors. Changing the form in the way proposed would put the Registrar in the position of seeking to regulate in a manner not authorized by the law which creates and binds the office.

Mortgage Brokers Who Act as Fiduciaries Already Have a Common Law Obligation to Disclose Compensation Details

Compensation disclosure obligations on mortgage brokers do not end with the MBA. There are common law obligations of disclosure which fall under the law relating to fiduciaries.

A fiduciary has a legal and ethical relationship of trust with his or her client. Fiduciaries have the highest standard of care in law. There must be no conflict of duty between the fiduciary and the client; further, the law requires that a fiduciary not profit from his position as a fiduciary without knowledge and consent from the client

If mortgage brokers are fiduciaries then they must disclose all compensation and benefits received from parties other than their client to their client. This would include disclosing to mortgage borrowers the amount of lender commissions received. The question then is, “Are all mortgage brokers fiduciaries of their clients?”

The Supreme Court of Canada in 2009 in *Galambos v. Perez* clarified that for a person to be a fiduciary, he or she must have undertaken to be one either expressly or implicitly. A person does not become a fiduciary of another person simply because they are in a power position compared to the other person. The importance of this decision for mortgage brokers is straightforward: mortgage brokers may explicit or implicitly by their conduct become fiduciaries but they are not inherently fiduciaries. Whether or not they are a fiduciary of their client depends on the nature of their relationship with their client, not on their job title.

A fiduciary is someone who:

- exercises discretion on behalf of clients rather than following instructions; and
- makes decisions for clients rather than giving the client information and equipping them client to make informed decisions.

An example of the court finding that a mortgage broker did not act as a fiduciary is found in the British Columbia Court of Appeal (2004) case in *Lindner v. Williams*. A couple lent money on a mortgage found by a mortgage broker. They lost money on the mortgage as the house at the time of foreclosure proceedings was devalued because it was a grow-op. The court said that whether a fiduciary duty exists depends upon the nature of the relationship, not the occupation of the person said to be a fiduciary. The lenders were aware that the mortgage broker's job was to find mortgage financing for borrowers and that he was not their financial advisor. Based on his functions, the mortgage broker was not a fiduciary.

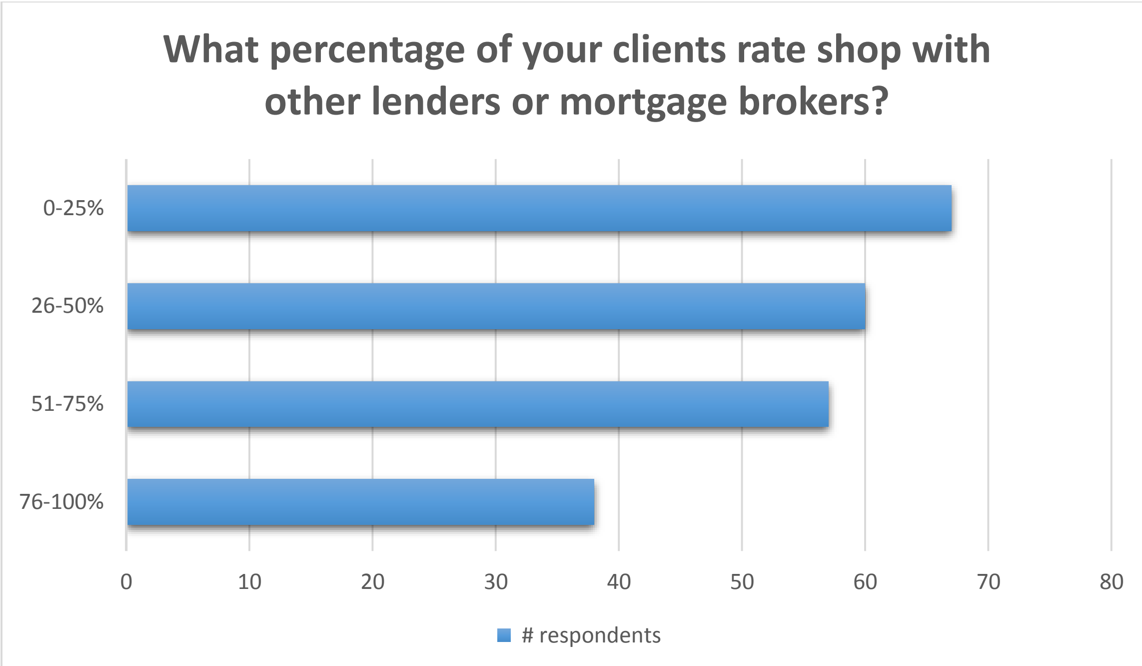
Mortgage brokers are therefore not by definition fiduciaries. It is the nature of their relationship with a client which makes them a fiduciary and not their job title. Some mortgage brokers may be fiduciaries and some may not be fiduciaries.

We conducted a survey of our members to determine whether they act like fiduciaries. This is what we found:

- 3% manage client assets or money – these brokers are acting as fiduciaries and currently obligated to provide detailed fee disclosure;
- 4.5% make decisions on behalf of clients - these brokers are acting as fiduciaries and currently obligated to provide detailed fee disclosure;
- 97.5% provide information to their client to assist the client in making informed decisions – these brokers are not acting as fiduciaries;
- 27% provide advice to their client – these brokers may be acting as fiduciaries and may have an obligation to provide detailed fee disclosure.

Mortgage brokers reported that a significant number of their borrower clients "rate shop". This is an important element of the analyses of whether mortgage brokers are fiduciaries, as borrowers who rate shop are treating the mortgage transaction like an ordinary retail transaction. They are shopping around for a mortgage like they would a couch or a car, and are not dependent upon the expertise or advice of single mortgage broker. They may rate shop with different mortgage brokers, banks or other lenders and will then analyse the information about different products to make their own decision on mortgage options.

We asked "Can you estimate what percentage of your client's rate shop with other lenders or mortgage brokers". This is the result:



The common law fiduciary obligation to make detailed fee disclosure to clients rests upon the submortgage broker who acts as a fiduciary. The benefit of the common law here is that there are no gaps or inconsistencies, such as those which exist in section 17.3. The common law of fiduciary duty therefore provides important public protection to those mortgage broker clients who are vulnerable and dependant on the expertise of the broker. It does not touch the mortgage broker who deals with the retail client who is neither vulnerable nor dependant on the broker. We believe this to be a balanced approach to compensation disclosure.

Detailed Compensation Disclosure Fails to Benefit and Actually Harms Mortgage Consumers

Requiring detailed compensation disclosure makes intuitive sense: more information provided to mortgage consumers can only assist them in their mortgage shopping process. In addition, it enhances transparency, and it is hard to argue against enhanced transparency. However, research shows that enhanced disclosure in the mortgage shopping process not only does not result in better decision making amongst mortgage borrowers, it also confuses them and results in them choosing significantly more expensive loans.

In 2002, the Department of Housing and Urban Development (HUD), in the United States, proposed to require that mortgage brokers disclose an estimate to mortgage borrowers of compensation received from lenders. The proposed disclosure was motivated by a concern that brokers were placing borrowers in above par loans without their knowledge and keeping yield spreads rather than passing on reduced interest rates to borrowers. The Federal Trade Commission (FTC), which initially supported the proposal, conducted a rigorous study of its efficacy, with detailed experiments involving mortgage customers from various geographical areas. It released a comprehensive report in 2004.

In particular, the FTC found (at page 45) that:

> *"mortgage broker compensation disclosure proposed by HUD is likely to confuse consumers, cause a significant proportion to choose loans that are more expensive than the available alternatives, and create substantial consumer bias against broker loans, even when the broker loans cost the same or less than direct lender loans."*

The FTC made strong and emphatic conclusions:

- The findings of this study indicate that broker compensation disclosures are likely to harm rather than help consumers and competition in the mortgage market.
- The disclosures are likely to lead a significant proportion of borrowers to choose more expensive loans by mistake.
- The disclosures are likely to cause a substantial bias against broker loans that may reduce competition and increase the cost of all mortgages.
- All three versions of the compensation disclosure tested in the study resulted in significant consumer confusion about loan costs and a substantial bias against broker loans. This included versions that moved the disclosure to a second page of the cost information.

The mistaken loan choices induced by the compensation disclosures could impose significant costs on consumers, both individually and as a whole. If the disclosure requirement has an impact similar to the magnitude found in one of the hypothetical loan cost scenarios examined in the study, *the disclosures would lead mortgage customers to incur additional costs of hundreds of millions of dollars per year.*

We are not aware of any other comprehensive study of mortgage broker fee disclosure and believe that the findings of the FTC study to be valuable.

A more valuable tool for mortgage borrowers to use in evaluating the costliness of various mortgage loan options is the annual percentage rate or APR. The APR is a singular number, which in theory incorporates the totality of all costs, fees, interest charges, mortgage amortization and terms. Every mortgage loan, whether brokered by a mortgage broker or not, has an APR. The APR once calculated can be used by the borrower to evaluate the cost of one mortgage over another. It eliminates any misperceptions which might be created by mortgage broker compensation disclosure that brokered mortgages are more expensive than lender direct mortgages. In addition, market forces will ensure that mortgage brokers provide mortgage options for borrowers with the most competitive APRs.

In view of the confusion and harm created by mandatory mortgage broker compensation disclosure, the lack of evidence to show that it is warranted, and the availability of other consumer protection tools such APR disclosure, it would not be in the public interest for the government to introduce mandatory fee disclosure to borrowers.

We applaud the Registrar for pursuing public protection measures. However, as a stakeholder in the mortgage industry, the MBABC expects to work with the Registrar to develop fair, clear, and legal disclosure requirements that aid the consumer. We recommend engaging in an open consultation on mortgage consumer protection issues to ensure that borrowers have appropriate safeguards and protections in place and that BC maintains a strong and vibrant financial services sector.

If you wish to discuss these matters, please do not hesitate to contact me.

Yours truly.

Samantha Gale

MBABC CEO