

Mortgage Brokers Issuing Promissory Notes

Mortgage brokers in Canada who arrange loans from clients using promissory notes may, at least in some circumstances, be breaching securities legislation. As Samantha Gale, CMBA Executive Director, said at page 14 of the Summer 2016 issue of the Canadian Mortgage Broker magazine:

The outward simplicity of a promissory note can be deceiving, in that it belies some very complicated regulatory requirements – with potentially devastating consequences for non-compliance. - (Samantha Gale, CMBA Executive Director)

The BC Securities Commission's April 19th, 2017 decision in Re Cook, 2017 BCSECCOM 136 verifies Ms. Gale's comment.

A person is not to distribute a security unless a prospectus is filed with the securities regulator or an exemption applies.

An unsecured, high interest bearing, promissory note is very strongly presumed to be a security. There is considerable doubt however that an interest-free note (essentially a non-investment) could be a security. Some examples of factors that support the presumption of the promissory note being a security in a specific instance include:

- The notes are unsecured.
- The monies are given to the broker with an investment intent.
- The investor is looking to make money on the promissory note (such as borrowing funds at a lower rate and lending them to the broker at a higher rate).
- There is no alternative regulator (Note that mortgage brokering regulators regulate conduct related to mortgages and not promissory notes. Nevertheless, a mortgage broker regulator may have a lot to say about a broker who borrows money from clients on the basis of promissory notes - issues of conflicts of interest, suitability for registration, and conduct prejudicial to the public interest potentially arise.)



Issuing or renewing a promissory note for valuable consideration is distributing and so trading in a security. Each renewal of the promissory note and the writing of replacement notes is a distribution of a security, even when no new funds are given to the broker.

The general rule is that a prospectus needs to have been filed with the securities regulator in order to trade in securities. There are exemptions to that requirement; the most common one in this context being that the promissory note providing the funds is a close friend or close business associate of the broker. The onus to prove that an exemption applies is on the person claiming it.