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BRIEFING NOTE

Mortgage Brokers Act Consultation: Cost of Credit Disclosure

On behalf of the Canadian Mortgage Brokers Association - BC (CMBA-BC), I thank you for the opportunity to make submissions in response to the consultation by the Ministry of Finance on proposed amendments to the *Mortgage Brokers Act* (the "MBA").
In this brief, we are reviewing provisions in Part 5 the *Business Practices and Consumer Protection Act* (BPCPA), which are incorporated into the MBA by reference and mandate the disclosure of mortgage transaction costs.

Current Status

Cost of credit disclosure under Part 5 of the BPCPA (incorporated into the MBA by reference) has been in effect in BC since July of 2006. It requires mortgage brokers and lenders to provide cost of credit disclosure to borrowers in mortgage transactions. The disclosure provisions require the disclosure of two key figures: an annual percentage rate (APR) and the total cost of credit, in addition to other important financial values and contractual information, such as prepayment privileges.

Cost of credit disclosure is relatively universal throughout all Western jurisdictions, including all Canadian provinces and the Federal government – however, the cost of credit disclosure regime set out in Part 5 of the BPCPA is one of the more complex examples of its deployment in a statute. The BPCPA is an omnibus consumer protection statute, which is not specifically geared for mortgage transactions, and the terminology and concepts do not neatly tie into the mortgage brokering and lending industry. I will lay out some of challenges with Part 5, although there are numerous additional examples of how it does not work and can be improved.

Challenges with the Current Status:

1. **Definition of Total Cost of Credit – Section 57 of BPCPA**

The "total cost of credit" is determined under section 57. In theory, it is a total dollar value which represents the sum total of all mortgage costs, including all fees, closing costs and accrued interest paid until the end of the mortgage term. While the concept is simple, section 57 complicates this computation by requiring that a person categorize various costs into value received, value given and costs not included in the cost of credit. The values in the categories of value given and value received must then be tallied and the difference between the two tallies will then equal the total cost of credit. Section 57 itself is too complex for most persons to readily grasp, and requires a reader to review a minimum of five definitions in order to determine the meaning of "total cost of credit".

Determining whether certain costs, such as legal, appraisal or survey fees constitute value received, value given or costs not included in the cost of credit depends on arbitrary distinctions contained in the definition of value received and value given. The arbitrary distinctions are unnecessary and create an overly complicated scheme of categorizing costs for the simple purpose of calculating the cost of credit for borrowers.

Take for example, legal fees. Under section 57, if the borrower has a right to choose their own lawyer, legal fees are not included in the cost of credit. Alternatively, if borrowers are not free to choose their own lawyer, legal fees are defined as value given and are therefore included in the cost of credit. However, it is not clear why this distinction is drawn. All mortgage borrowers need to retain the services of a lawyer or notary to attend to the conveyancing process on their behalf, and will incur conveyancing costs regardless of restrictions on the choice of conveyancer. The only possible rationale behind distinguishing conveyancing fees based on choice of lawyer or notary is that borrowers with restricted choice may not be in a position to bargain for the cheapest conveyancing fees.

We can also look at how appraisal and survey fees are treated. Under section 57(2)(e)(ii), if the borrower has a right to give an appraisal or a survey to third parties, the appraisal or survey fee is not included in the cost of credit. However, if the borrower is not given the appraisal or survey and has no right to give it to third parties, then the appraisal or survey fee is defined as value given, and is therefore included in the cost of credit. It is not clear why this distinction is necessary, as the real value of an appraisal or a survey may be completely insignificant to a borrower even if they are free to give these documents to third parties.

As a matter of industry practice, mortgage appraisals are ordered by lenders for their benefit and are rarely given to purchasers. Whereas, surveys are usually ordered by the conveyancing lawyer, and are given to the borrower. However, surveys obtained for the purposes of mortgage financing contain basic survey measurements and are referred to in the industry as “mortgage surveys” and are for “mortgage purposes only”. A property owner will not be able to use a mortgage survey for other purposes, such as applying for development permits with municipal authorities, as a more in-depth survey is required.

Appraisal reports, if given to the borrower for future use, also have limited applicability. Lenders often require that appraisals be done by a specific list of appraisers and another lender may not accept a borrower’s previously obtained appraisal. In addition, an appraisal will quickly become outdated and lenders may require a new appraisal if the old one is even just several months old. Appraisal reports and surveys, even if given to borrowers for their own use, may have limited future value to the borrower. It therefore does not make sense to create an arbitrary distinction based upon whether they can be given to third parties in order to determine whether their cost should be included in the cost of credit.

2. The APR Formula -Section 6(2) of the *Disclosure of the Cost of Consumer Credit Regulation*

The annual percentage rate of a mortgage loan is the yearly cost of a mortgage loan, which includes all fees, disbursements and interest costs, expressed as a percentage rate. It is essentially the contract interest rate of a mortgage with all additional costs incorporated into the rate. Theoretically, if the contract interest rate is 10% and there are no extra mortgage origination costs, the APR is also 10%. The APR is intended to be an indisputable, simple figure, which can be used by mortgage borrowers to compare the cost of various mortgage options. However, APR values can vary wildly depending on the method used to compute it. Discrepancies in APR values will be most pronounced in mortgage transactions with shorter terms and greater financing costs.

One explanation for this is that the APR calculation in section 6(2) requires a different treatment of the outstanding principal over the term (“P”) than the APR formulas set out in other, comparable statutes. It requires that P (the average outstanding principal over the term) be calculated after each installment payment is applied firstly to accrued interest costs, secondly to any outstanding non-interest finance costs and thirdly against the outstanding principal.

I note that our own association cost of credit spreadsheet does not even calculate P by applying each instalment payment secondly to non-interest finance charges, in accordance with section 6(2). Some APR calculators or spreadsheets gross up the principal by adding the non-interest finance charges to the principal and then determining the average outstanding balance after the application of the instalment payment. Other APR calculators simply do not take non-interest finance charges into account. Mortgage brokers generally calculate the APR using commercially available

APR calculators or spreadsheets which may not calculate the APR in accordance with section 6(2).

3. <u>Lack of Cost of Credit Disclosure for Reverse Mortgages – Sections 81 and 84 and Section 7 of the *Disclosure of the Cost of Consumer Credit Regulation*</u>

A reverse mortgage is a loan secured by a mortgage registered against the title of the borrower's principal residence, where payments are not periodic, but are made in a lump sum at the end of the term. The term is indefinite and expires when the borrower no longer resides in his or her home, usually due to the death of the borrower or abandonment or sale of the home. The lender will usually pay a fixed amount of principal to the borrower in a lump sum, but may also pay regular payments to the borrower throughout the term of mortgage. Reverse mortgage borrowers are always senior citizens, who represent a vulnerable sector of society requiring the most protection afforded by consumer protection legislation.

However, Part 5 of the BPCPA does not require the lender to disclose the amount of rising debt that the borrower will incur under the reverse mortgage. In addition, under section 84, the lender does not have to disclose the total cost of credit to the borrower, as a reverse mortgage appears to not fit within the definition of a "scheduled payments credit agreement" in section 81. Under section 84, the total cost of credit does not have to be disclosed for mortgage loans which are not scheduled payments credit agreements. The information to be disclosed to reverse mortgage borrowers under section 84 is therefore extremely limited, and of little value.

Section 7 of the *Disclosure of the Cost of Consumer Credit Regulation* requires that the APR for a fixed credit agreement that is not a scheduled- payments credit agreement be calculated on the assumption that the outstanding principal will be repaid in a single payment one year after the effective date of the relevant disclosure statement. However, some reverse mortgages often contain a lower rate of interest for the first year, which will then increase in subsequent years of the reverse mortgage term. The APR for a reverse mortgage when it is calculated only for one year, will therefore not reflect the escalating cost of borrowing for most reverse mortgage borrowers.

In addition, new forms of equity lending, whereby the lender will take an equity ownership interest in a property in lieu of periodic mortgage payments are emerging and cost of credit disclosure requirements are equally ill suited to these arrangements. It is also worth noting that despite the challenges in statutory cost of credit disclosure requirements, reverse mortgage providers generally fill in information gaps by providing their own explanations of future mortgage costs and equity reduction in the form of tables and graphs.

Recommended Changes

We recommend the following in relation to cost of credit disclosure:

(1) The MBA should contain its own mortgage transaction specific cost of credit disclosure requirements which are simplified, and Part 5 of the BPCPA should be abandoned in its entirety. A specific, required cost of credit form should be considered for inclusion in regulations to the MBA.

(2) A simpler framework should be created where the total cost of borrowing is simply the total of all interest costs plus certain included mortgage transaction costs, which are then listed in the disclosure form. Fees for appraisals, surveys and conveyancing should be contained in the list of included costs without any additional, arbitrary assessments of those costs, such as the choice of lawyer or freedom to give a report to a third party.

(3) A simpler APR formula should be adopted which more closely mirrors the calculation protocols from other jurisdictions. The APR should be capable of calculation using commercially available APR calculators.

(4) A further, separate detailed review of cost of credit disclosure requirements should be undertaken for non-traditional mortgages with balloon or lump sum payouts, including reverse mortgages, and equity ownership mortgages where the lender has a form of equity interest in the property

Yours truly,

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