

Increased Regulatory Enforcement of Compliance Obligations of Mortgage Brokers and Administrators

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Over the last year, the Financial Services Commission of Ontario ("FSCO") has been aggressively monitoring the compliance by mortgage brokers and mortgage administrators with the provisions of the *Mortgage Brokers, Lenders and Administrators Act, 2006* (the "Act"). FSCO's enforcement activities have focused primarily on whether mortgage brokers and administrators have implemented the policies and procedures required under the Act.

The penalties for non-compliance with the Act are stiff. The Superintendent of Financial Institutions has the power to impose administrative monetary penalties for contraventions of the Act by mortgage brokerages or administrators (or entities that should be licensed as mortgage brokerages or administrators) of up to \$25,000, and may impose administrative monetary penalties of up to \$10,000 for contraventions of the Act by an individual who is, or should be, licensed as a mortgage broker or agent.

In 2009, FSCO imposed over 100 administrative monetary penalties totalling almost \$100,000 against mortgage brokers. These include numerous penalties of \$1,000 to mortgage brokerages that failed to file an annual information return and numerous penalties of up to \$1,000 to mortgage brokerages that failed to hold proper E&O insurance.

In addition, the Act prescribes more serious offences for which the penalties are fines of up to \$100,000 and imprisonment for up to one year for individuals. Corporations found guilty of such offences are subject to fines of up to \$200,000, and every director who has acquiesced or participated in such an offence, or failed to use reasonable care to prevent the offence, is also guilty of an offence. These offences include carrying on business as a mortgage broker, lender or administrator without a proper licence; failing to comply with an applicable standard of practice; and providing false or deceptive information while carrying on the business of a mortgage broker, lender, or administrator.

Mortgage Brokerages - Required Policies

Under the *Mortgage Brokers: Standards of Practice Regulation*, mortgage brokerages are required to establish and implement policies to ensure that the brokerage and its authorized brokers and agents comply with the requirements under the Act. Mortgage brokerages should adopt written policies and procedures with respect to:

- Disclosing which party (or both) the brokerage represents (or whether it represents both parties);
- Verifying the identity of borrowers, lenders and investors;
- Determining suitability of a mortgage or mortgage investment for borrowers, lenders and investors;

- Identifying and disclosing the material risks of a mortgage or mortgage investment;
- Identifying and disclosing potential conflicts of interest of the mortgage broker;
- Receiving incentives, other than money, by agents or brokers (other than from the brokerage) for dealing in mortgages;
- Paying incentives, other than money, to agents or brokers of other mortgage brokerages;
- Ensuring that brokerages, brokers and agents comply with their responsibilities under the Act;
- Ensuring that brokers and agents are adequately supervised;
- Handling and responding to complaints;
- Handling and retention of records;
- Managing trust accounts;
- Filing annual information returns and financial information; and
- Maintaining errors and omissions insurance.

Preparing the written policies is a necessary first step to ensuring compliance with the Act. However, it is equally important that all licensed brokers and agents (and any other affected staff) are aware of their obligations under such policies. Accordingly, mortgage brokerages should provide (and document) the training provided to staff on their policies, and should perform ongoing training and monitoring to ensure that staff are complying with those policies.

FSCO's Compliance Review of Mortgage Brokerages

In May 2010 FSCO released its *Report on FSCO's Compliance Review of Mortgage Brokerages* (the "Report"), which examined the compliance by mortgage brokerages with the requirements under the Act. FSCO's review, which included on-site inspections of approximately 10% of all mortgage brokerages in Ontario, focused on standards of practice of mortgage brokerages, and in particular those relating to policies and procedures, oversight and corporate governance.

The Report found that "most mortgage brokerages have written policies and procedures that are generally in compliance with the standards of practice under Ontario Regulation 188/08 [the *Mortgage Brokers: Standards of Practice Regulation*] ...in many cases, the brokerages had communicated their policies and procedures to their mortgage brokers and agents". The areas FSCO specifically identified for improvement are:

- Syndicated mortgages;
- Restrictions on payments by the brokerage;
- Provisions governing payment of incentives other than money; and
- Records retention.

FSCO Examiners asked the selected mortgagee brokerages a number of questions to determine compliance with the Act, and categorized the responses as either low risk, medium risk or high risk. High risk activities were those for which 25% or more of the responses failed to comply with the requirements under the Act. High risk activities identified by the Report include the following:

- Signage and promotional materials failing to prominently disclose the brokerage's licence number and legal name;
- Failure to maintain records of training provided to brokers and agents;
- Policies and procedures failed to include:
 - provisions to ensure compliance of brokerage, its brokers and agents with the requirements of the Act;

- provisions for incentives other than money for dealing in mortgages:
 - to brokerage's brokers and agents by other persons, or
 - to another brokerage's agents or brokers;
- requirement to notify FSCO of any brokers or agents not suitable to be licensed;
- requirement to terminate access of brokers and agents to the software provider on termination of employment;
- provisions requiring the brokerage to pay fees for trading in mortgages only to licensed entities or entities exempt from licensing requirements and not to pay fees directly to another brokerage's brokers or agents;
- requirements that documents and records be retained for six years after the expiry of the mortgage in Ontario; and
- requirement that documents be returned to borrowers, lenders or investors on demand;
- Mortgage brokerages that deal in syndicated mortgages failing to have policies and procedures with respect to such syndicated mortgages; and
- Trust bank account records failing to distinguish between trust funds and other assets of the brokerage.

Mortgage Administrators - Required Policies

The standards of practice applicable to mortgage administrators, including the obligation to establish policies and procedures to ensure compliance with the Act, are enumerated in the *Mortgage Administrators: Standards of Practice Regulation*. Mortgage administrators should establish written policies and procedures with respect to:

- Verifying the identity of lenders;
- Advising lenders if the mortgage administrator will pay or receive fees from any other person in connection with the administration of the mortgage, or if the administrator will receive a referral fee in connection with the lender;
- Identifying and disclosing potential conflicts of interest to the lender;
- Ensuring that all mortgage administration agreements contain the information required by the *Mortgage Administrators: Standards of Practice Regulation*;
- Ensuring that all individuals acting on behalf of the mortgage administrator are adequately supervised;
- Handling and responding to complaints;
- Handling and retention of records;
- Managing trust accounts;
- Filing annual information returns and financial information; and
- Maintaining errors and omissions insurance.

Review of Mortgage Administrators by FSCO

The examinations of mortgage administrators currently being conducted by FSCO require the mortgage administrators to produce the following documents for inspection by the FSCO Examiner:

- Current audited financial statements;
- Policies and procedures, including training procedures and manuals;
- Standard mortgage administration agreement, which must contain all the terms required by the *Mortgage Administrators: Standards of Practice Regulation*;

- Listing of officers, directors, offices open to the public and trust bank accounts;
- Most recent monthly reconciliation statement for trust accounts;
- Documentation confirming compliance with required \$25,000 financial guarantee; and
- Information as to the number of mortgages administered and their dollar value, the number of syndicated mortgages and their dollar value, the number of mortgages in arrears and their dollar value and the number of lenders/investors.

If you are a mortgage brokerage or mortgage administrator, we can help you prepare the necessary policies and procedures to ensure compliance with the Act and the Regulations. We can also assist if you are selected for an examination by FSCO. ■