CHAPTER 21

MORTGAGE BROKERING: BLENDING THEORY AND PRACTICE

Learning Objectives

After studying this chapter, a student should be able to:

- ☑ Merge the theory introduced in the previous chapters with the mortgage brokerage practice
- ☑ Explain how to conduct an initial client interview to obtain the information needed to match a client to an appropriate mortgage product
- ☑ Discuss the actions that a mortgage broker might take to make an informed recommendation about mortgage product alternatives
- ☑ Explain mortgage application best practices
- ☑ Describe what is involved in pulling a client's credit report
- ☑ Discuss the post-closing steps in the mortgage process

INTRODUCTION

The course thus far has covered a variety of general topics pertaining to mortgages and mortgage brokerage such as public protection, interests in real property, contracts, mortgage finance, valuation, loan management, and completion procedures. In this chapter, the theories introduced throughout the course will be applied in a practical manner. This chapter consists of a detailed walkthrough of a sample prime residential mortgage transaction from start to finish. The focus is on the areas and activities that constitute "arranging mortgages" as defined by the Registrar of Mortgage Brokers (the Registrar) and as referenced in British Columbia's *Mortgage Brokers Act* (MBA).

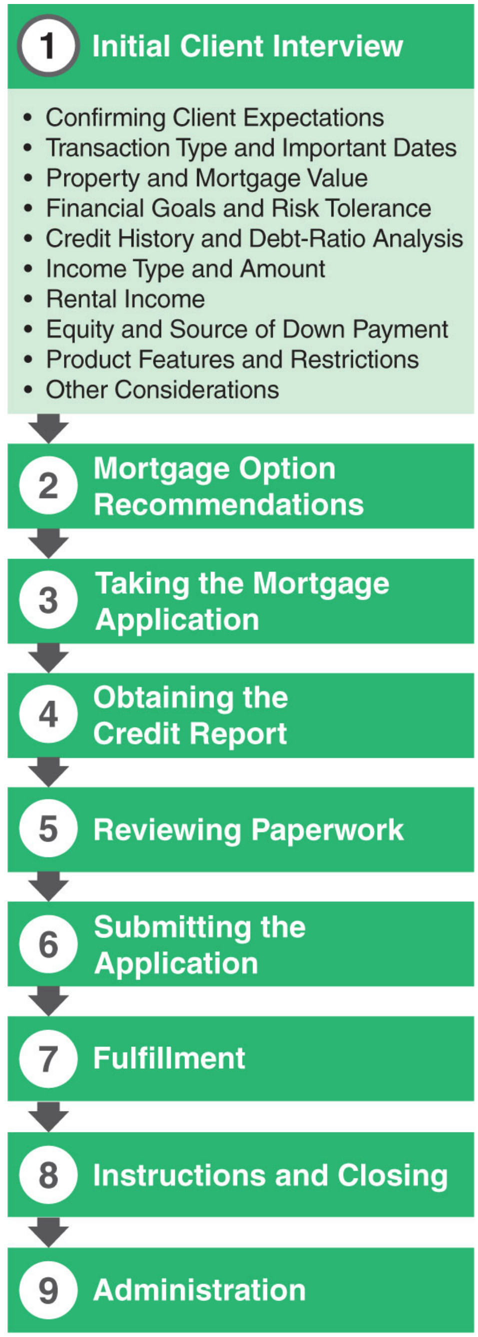
The *Mortgage Brokers Act* and the definition of "mortgage broker" were introduced in **Chapter 2**

ALERT

As you read through this chapter, keep in mind that it serves only as a generalized discussion. Each mortgage transaction has its own unique circumstances; therefore, the process introduced here is only an example. The following case and information is presented to help to illustrate the application, underwriting, and closing procedures for a residential mortgage transaction.

INITIAL CLIENT INTERVIEW

Mortgage brokers have a duty to recommend the most suitable product they can access for each client who retains their services. To do this, the mortgage broker must have a detailed understanding of the client's unique situation and needs. This knowledge can only be obtained by asking thoughtful questions to assess and qualify the client. Lenders also expect the mortgage broker to know their client and to submit appropriate and comprehensive applications. This is why virtually every mortgage broker speaks to their clients, in person or by phone, at the beginning of the mortgage transaction process, at the end, and at various stages in between.



The initial client interview is the most important conversation that a mortgage broker will have with their client. This is where an applicant's qualifications and true needs become apparent. With the right questions, all of the essential information needed for a mortgage approval can be obtained at this stage. A mortgage broker should take detailed notes during the initial client interview and retain them in the client's file, should any discrepancies or issues arise later.Each of these topics will be discussed in detail in the following sections – but first, consider the following mortgage scenario:

At a minimum, the following should be discussed in the initial client interview:

- client expectations;
- the transaction type;
- important dates;
- property and mortgage values;
- financial goals;
- affordability;
- credit history;
- debt-ratio analysis;
- income type and amount;
- rental income;
- equity and the source of the down payment;
- risk tolerance;
- product features; and
- product restrictions.

Each of these topics will be discussed in detail in the following sections – but first, consider the following mortgage scenario:

Case Study

As a first-year mortgage broker, you are excited to get started. You have just received a call from a couple, Steve and Patricia Jones, who are looking to purchase their first home.

Steve is an insurance agent and Patricia has her own business working part-time as a bookkeeper. Steve earns $80,000 per year in salary and commission, plus a bonus. Patricia earns approximately $55,000 per year net (after deducting her business expenses). They rent their current accommodations but are keen on purchasing a single-family home, having saved a 20% down payment. However, cash flow is a little tighter than they'd like; therefore, they are looking for a house with a basement suite for extra rental income (i.e., a "mortgage helper").

Like most borrowers, Steve and Patricia are heavily focused on the interest rate they'll receive. This is a good starting point, and where you have an opportunity to discuss the client's expectations and to explain how your services and value as a mortgage broker go well beyond quoting a number, such as an interest rate.

We will learn more about Steve and Patricia as the chapter progresses.

As a Mortgage Broker...

On January 1, 2023, the *Prohibition on the Purchase of Residential Property by Non-Canadians Act* (the "Act") and its regulations came into force. The Act prohibits a "non-Canadian" from purchasing, directly or indirectly, residential property until January 1, 2025.

The definition of "non-Canadian" is complex but is generally those who are not Canadian citizens, "Indians" under the *Indian Act*, permanent residents, or Canadian corporations with less than 10% non-Canadian ownership or control, among others. There are exclusions for international students, work permit holders, and refugees, but only if certain conditions are met in each case, such as an international student having filed Canadian income tax returns for a number of years. There are also exemptions for certain estate, family law, trust, secured lending, and property development scenarios.

The ban applies to "residential property", which generally includes detached houses, semi-detached houses, rowhouses, and residential strata units, if the property is located within a census agglomeration ("CA") or a census metropolitan area ("CMA"). Most municipalities of 10,000 residents or more are included within a CA or a CMA. Notably, land that does not contain any habitable dwelling, that is zoned for residential use or mixed use, and that is located within a CA or CMA, is not captured by the definition of "residential property", and so can be purchased by non-Canadians.

The Act sets out significant penalties for non-compliance. Every non-Canadian, as well as any other person who counsels, induces, aids, or abets or even attempts to counsel, induce, aid or abet a non-Canadian to purchase a residential property in Canada is guilty of an offence and liable on summary conviction to a fine of not more than $10,000. The activities of mortgage brokers could fall within this section, along with lawyers, notaries, real estate agents, and other professional advisors. Mortgage brokers could also be disciplined by BCFSA for their role in a breach of the Act.

While the sale of a residential property to a non-Canadian may be in breach of the Act, the sale may still be valid at law, and as such, a court may order that the residential property be sold. A court would have the discretion to make other orders that it considers necessary, such as ordering that, on the sale of the property, the non-Canadian cannot recover more than what they paid for the property (i.e., the non-Canadian cannot profit from the court ordered sale of their property).

Confirming Client Expectations

From the client's point of view, there are three main characteristics that differentiate a mortgage broker from a *lender representative* (i.e., a mortgage salesperson representing a single lender):

- choice;
- competitive pricing; and
- comprehensive advice.

lender representative
a mortgage salesperson representing a single lender, e.g., a mortgage specialist at a national bank

The essence of a mortgage broker's value proposition is offering consumers access to a wide array of lenders and mortgage products. Whereas a lender representative employed by a financial institution typically sells only mortgages from their own financial institution, a mortgage broker can deal with dozens of lenders. This characteristic affords a greater opportunity to find a product with features that closely matches the client's needs.

Why Consumers Use Mortgage Broker Services

According to Mortgage Professionals Canada (MPC), the top five reasons that consumers say they choose to consult a mortgage broker are:

1. "To get the best rate" (67%)
2. "To get multiple quotes" (40%)
3. "So I didn't have to do the research myself" (37%)
4. "To help me understand my options and the process" (33%)
5. "To help me with the paperwork" (31%)

Note that survey respondents were able to select more than one option.

Source: Mortgage Insights Report – January 2015

At any given moment, different lenders will charge different interest rates on different mortgage products. Mortgage brokers are able to access multiple lenders, all of whom are competing against one another. This improves the mortgage broker's ability to offer lower borrowing costs and more suitable terms for the client, versus a lender representative who can only provide access to a single lender's rates and products. Industry surveys consistently show that access to low rates is the primary reason why consumers turn to mortgage brokers to provide mortgage services.

By staying up-to-date with products and policies from multiple lenders, a mortgage broker builds comprehensive and valuable knowledge of which mortgages best match the qualifications, risk tolerance, and needs of their clients. This information can be effectively applied when a client seeks a particular combination of features or has unique needs (e.g., income that cannot be documented in the traditional manner, a higher risk credit profile, or a unique property). Different lenders serve different niches and the more knowledge a mortgage broker has of these niches, the greater the probability of being able to recommend the most suitable mortgage product for the client.

Case Study, continued

For your clients, Steve and Patricia, it could be particularly advantageous to have a selection of potential lenders. This is because their income is variable (including commission, bonus, and self-employed earnings) and is therefore not as straightforward to prove as a salary or an hourly wage. They also need a lender that will recognize as much of their rental income as possible. This will lower their gross debt service ratio below lender limits and help them qualify for a mortgage.

One of the most effective ways in which a mortgage broker can set appropriate expectations is by documenting those expectations in a written agreement. The Registrar recommends that, at the beginning of every transaction, a mortgage broker should have each client sign a Client Service Agreement and Authorization that sets out:

- the parameters of the services to be provided to the client;
- the cost of, or fees for, the services to be provided by the mortgage broker, if any;
- all authorizations that may be required by the mortgage broker or lender, such as a credit bureau authorization and a consent to disclose information necessary to the completion of the mortgage (e.g., to the client's real estate agent, insurance agent, and conveyancing lawyer or notary public); and
- the client's responsibility to bear other costs of the mortgage, such as fees related to:
    - an appraisal of the subject property;
    - discharge of an existing mortgage;
    - legal work and registration of the mortgage;
    - title insurance; and
    - property transfer tax.

Transaction Type

The initial interview will continue with a discussion to determine the type of transaction the client is undertaking and should address the following:

- Is the client:
    - purchasing a new property;
    - refinancing an existing mortgage; or
    - switching lenders with no change in the loan amount, loan-to-value, amortization, or title?
- Does the client need a secured line of credit, money for improvements or renovations, or a draw mortgage for construction?

Mortgage loan repayment and refinancing options were discussed in **Chapter 14**

Important Dates

Dates are set out in the contract of purchase and sale for the satisfaction/removal of financing subjects, possession, and closing (i.e., the completion date). Note that the closing date is not to be confused with the possession date, which commonly occurs one day after completion.

If a client has financing subjects and/or conditions, it is necessary to allow ample time to arrange a firm approval for the client. The average time required to obtain a conditional approval from a lender, to have the lender review documentation, and to obtain an appraisal (if necessary) is five business days; however, approvals can take longer for non-prime financing or complex applications and delays can occur if the chosen lender is extremely busy.

Important dates in a real estate purchase were discussed in **Chapter 20**

Case Study, continued

Steve and Patricia ask you if they can submit an offer without a financing condition. Knowing their atypical income situation and the need for an appraisal, you explain that this is too risky and advise them to request that their real estate agent include a five-day financing subject in any offer that they submit to purchase a property. To ensure the lender prioritizes this application, you ask the business development manager at the lender to notify the underwriter that this is a time-sensitive purchase. This must be done immediately after you submit the application to the lender. You then instruct your clients to send you all key documentation within 24 hours of the interview.

Lending and Market Value

Lending value is a long-term, conservative estimate of the value of the property pledged as security for the loan. Lending value is generally less than market value, sometimes equals market value, and almost never exceeds market value. For example, for a property purchase, prime lenders (including most major banks and credit unions) might use the purchase price as the lending value, even if the market value of the property has appreciated since the borrowers first purchased it. Keep in mind that the market value of a property may increase or decrease over time.

Another factor that must be determined is the amount of the down payment, which will determine the required mortgage amount. When calculating the mortgage amount, the mortgage broker must be cognizant of mortgage default insurance fees and any amounts that the client wishes to have incorporated into the mortgage loan amount such as payouts of credit cards, prepayment charges from a previous lender, legal fees, etc.

Lending value and market value were discussed in **Chapter 12**

Financial Goals

The mortgage broker must determine what the client hopes to achieve financially and how the mortgage can be used to support these goals. For example, does the borrower need a secured line of credit with their mortgage to fund a business, rental property purchase, or investment purchase? Is the client expecting a bonus, settlement, or inheritance that will allow large prepayments?

Case Study, continued

Steve and Patricia saw an ultra-low rate advertised online, but you know that this rate comes with only 5% prepayment privileges. In other words, only 5% of the outstanding balance of the mortgage can be prepaid per year. However, in your interview, you learn that Patricia expects to receive a large legal settlement in the next three months or so and wants to use it to pay the mortgage off faster. Therefore, you recommend a slightly higher rate with 20% prepayment privileges. You calculate that a slightly higher interest rate that allows them to pay down their mortgage quicker will save them $1,200 more over their term, compared to the lower rate.

Risk Tolerance

Stress-testing a client's budget involves an analysis of how the client will be able to manage certain variances. For example, how easily can the client afford a two or three percentage point increase in the interest rate? The mortgage broker must also understand the client's liquid assets, which can be vital in continuing to make mortgage payments should circumstances change. For example, if the client's income becomes interrupted for three to six months, will the client be able to afford their mortgage payments? The answers to these questions will help the mortgage broker determine the most appropriate terms for the mortgage (e.g., a longer-term mortgage with a fixed interest cost versus a variable rate mortgage).

stress-testing
the sensitivity analysis of how the client will be able to manage certain variances

It is also important to note that all mortgages are required to qualify at the Bank of Canada's qualifying rate or an additional 2% above the mortgage's negotiated contract rate, as discussed in Chapter 12. The intent of the qualifying rate is to make sure that a borrower can afford higher payments, should interest rates rise.

Credit History

Lenders prefer to see a history of the client's ability to manage sizeable credit obligations. The following guidelines are common industry standards in this regard:

- Does the client have at least two established trade lines (on their credit report) such as credit cards, car loans, or lines of credit?
- Does the client have a minimum credit limit of $2,000 on each of those trade lines?
- Does the client have a two-year history with each trade line?

Credit reports and scores were discussed in **Chapter 12**

If a client needs help with improving their credit, the mortgage broker may recommend strategies including:

- obtaining secured credit cards or loans;
- reducing credit utilization below 70% of each revolving account's credit limit;
- paying unpaid bills; and
- correcting credit report errors.

If the client has poor credit, they may only get approved for a shorter mortgage term. One- or two-year terms are popular for credit-challenged borrowers because they generally allow enough time to remediate the lender's credit problems. That way, the applicant can refinance sooner at better rates and on better terms with the same or an alternate mortgage lender.

Case Study, continued

Steve's credit score is 780, which is above average. Patricia's is 681, which barely clears the industry guideline for a low-risk credit of 680. Had her credit score been less, it would have reduced their choices of lenders and potentially caused the clients to pay a higher interest rate.

Debt-Ratio Analysis

The client must have a gross debt service ratio (GDSR) and a total debt service ratio (TDSR) within standard industry guidelines (i.e., less than a 35% GDSR and less than a 42% TDSR). Even if the client falls within official lender guidelines, it must still be determined whether or not they can truly afford the mortgage payments.

Debt service ratios and income types were discussed in **Chapter 12**

Income Type and Amount

If the client's income is not all salary, the mortgage broker should assess whether there is bonus, contract, commission, part-time, or self-employed income. If any of these are present, the mortgage broker must identify the two-year average of income, according to the client's Notice of Assessment from the Canada Revenue Agency (CRA).

If the client is self-employed and/or earning dividend income, the T1 general tax return should show the source of income. The mortgage broker must determine whether the lender will permit the client to *gross up* any of this income in order to reduce the debt ratios. For example, it is very common for lenders to allow a 15% gross-up on provable self-employed income that appears on line 150 of CRA's Notice of Assessment. Alternatively, some lenders allow a borrower to add back write-offs to their income such as capital cost allowance, motor vehicle expenses, and business use of a home. The mortgage broker can identify items that may be added back to the client's income by reviewing the client's tax return (particularly the Statement of Business Activities).

gross up
increasing the net income to account for business deductions (e.g., car payments on a vehicle used as part of the business) or non-taxable income (e.g., permanent disability insurance)

As a Mortgage Broker...

You can advise your clients to obtain their notice of assessment (NOA) through My Account, CRA's online service, or the MyCRA mobile app. Through these services, taxpayers have immediate access to their NOAs and can request a Proof of Income Statement to be received by mail within a few days, free of charge. Be wary of any individuals or businesses charging a fee for the service of obtaining a NOA.

Alternatively, if your clients do not have access to My Account or MyCRA, they can phone CRA to request that a copy of the Proof of Income Statement be mailed to them. However, the processing time is slower for these requests and will take approximately four weeks. In a time-sensitive situation, it is best to advise your clients to request their Proof of Income Statement electronically.

Note that CRA does not permit third parties to obtain the NOA on behalf of a client using Form TI013, Authorizing or Cancelling a Representative.

Case Study, continued

Given that Patricia is self-employed, you have found a lender that allows you to gross up her $55,000 Line 150 income by 15%, giving her $63,250 of income for underwriting purposes. This helps her qualify for the slightly larger mortgage that Patricia and Steve need.

As for Steve, you ask for his last two years of Notices of Assessment so that you can take a two-year average of his bonus income, which is the standard most lenders use to validate bonus income. Steve's salary can likely be proven with a job letter and his most recent pay stub, although this will depend upon the particular lender's requirements.

Rental Income

In cases where the client receives rental income from another property, various lenders and insurers will treat this income differently. The type of rental income treatment depends on how conservative the lender is, how it funds its mortgages, whether the mortgage is insured, and the lender's general appetite for financing rental properties. Furthermore, mortgage default insurers may have different policies for recognizing rental income.

Lenders will typically consider the potential for vacancy, repairs, and other unexpected expenses; therefore, they will often use less than 100% of the client's rental income when calculating debt ratios. Some lenders allow only 50% of the rental income to be used (called a "50% rental add-back"). Some will allow 80% of the income to offset debt payments (called a "rental offset"). Others will require that expenses be deducted from the rental income, with the balance being added to the rest of the borrower's income (called a "net rents" calculation).

Case Study, continued

Steve and Patricia have found a house with a legal basement suite that is being rented by a tenant. You have found a lender that will allow 80% of that rent to be deducted from their other monthly obligations, thus helping to lower their TDSR to below the lender's 42% maximum.

Equity and Source of Down Payment

An important discussion during the initial interview involves determining how much equity is available to the client. If the client is using the mortgage to purchase a property, it should be noted whether any portion of the down payment is a gift, borrowed, and/or derived from foreign sources.

If the down payment is borrowed, the mortgage broker must include the monthly payments in the debt-ratio calculations and ensure that the lender allows down payments to be made by way of borrowed funds. If the down payment is a gift, the client will need to obtain a signed gift letter from the giftor. Note that some lenders will only accept gifted down payments from immediate family members. If the down payment comes from foreign sources, the mortgage broker should check that the lender allows this. Most lenders that allow this want to see foreign down payment funds deposited in a Canadian bank account for a minimum number of days, often at least 30 to 90 days before closing. Note that foreign funds coming from certain countries, including China and Iran, may experience further delays and complications.

Case Study, continued

Steve and Patricia have stated that they saved up their down payment from their own income; therefore, you ask them for three months of bank statements to show the funds in their possession, as required by the lender.

Product Features

In order to select the mortgage that is best suited to the client, the mortgage broker should ask the following questions:

- Does the client have the ability to prepay large portions of their mortgage, thus necessitating sizable prepayment privileges? Or do they have little discretionary cash flow, making a lower interest payment more important?
- Will the client need additional funds prior to the mortgage's maturity, necessitating a favourable *blend and increase* policy? Some lenders do not permit blends and increases without a penalty, or they may charge uncompetitive rates on the additional funds.

blend and increase
the process of increasing a mortgage size, whereby the lender blends the old interest rate on the existing mortgage balance with its current interest rate on the new borrowing

- Will the client likely move during the term, necessitating flexible portability privileges and the availability of bridge financing? This is especially common for growing families that are expecting more children. If portability is essential, the mortgage broker should find a lender that allows borrowers at least 60 days to port without penalty. Many lenders allow only 30 days or less. Most credit unions do not allow porting out of the province, which is relevant if the client's employment gets transferred out of province.

- Does the client want the option to extend the term (i.e., *early renewal*)? This may be useful if interest rate risk is high and the borrower does not want to wait until maturity to lock into a long-term interest rate.

early renewal
renewing a mortgage early, before the end of its term

Portable mortgages were discussed in **Chapter 11**

Product Restrictions

The client must be made aware of product restrictions on the mortgage. For example, the client should determine whether a lower interest rate is worth the trade-off of higher prepayment charges (i.e., penalties) and/or the inability to break the mortgage early to refinance elsewhere.

High penalties, based on a three months' interest penalty or the interest rate differential (IRD), can trap a client with a lender. Penalties can prevent the client from refinancing – or, worse, prevent them from moving – which can seriously impact a client's job mobility and lifestyle flexibility.

Prepayment penalties were discussed in **Chapters 13** and **14**

Other Considerations

Other factors to consider during the initial interview include the following:

- If the client plans to lock in a variable rate, some lenders have more competitive conversion rates than others.
- If the client has recently had a marital separation, lenders commonly require the client to provide a final signed separation agreement.
- If the client is near retirement age and facing an impending reduction in income, they may need a long-term fixed rate for financial stability.
- If the client needs to use income from a guarantor who will not be on the title to the mortgaged property, they must be aware that only a minority of lenders will allow this, due to legal concerns in the event of default.

- A client who is going through the mortgage process for the first time may require additional time and attention from the mortgage broker. Some clients rely much more heavily on a mortgage broker's recommendations than others.
- If the client will potentially need to move out of the province, this may eliminate credit unions as potential lenders, whose portability features may only apply to in-province moves.

As a best practice, the mortgage broker should document all responses to the client interview questions pertaining to mortgage suitability. This protects both the applicant and the mortgage broker from disputes relating to what occurred in the application stage later on in the process.

ALERT

The Registrar receives numerous complaints from lenders that have received misleading or false information in a mortgage application. Such conduct constitutes mortgage (or application) fraud. Occurrences of this nature can tarnish the reputation that mortgage brokers have with the general public and within the lending community. While a mortgage broker is not expected to conduct in-depth investigations of every transaction they process, reasonable due diligence must be undertaken to ensure that the information being passed on to lenders is accurate – this is an important step towards minimizing the occurrence of mortgage fraud, a growing problem in Canada.

Furthermore, a mortgage broker may become aware of various "red flags" with the client file during the initial client interview, and turning a blind eye or being complacent towards such red flags at this stage in the file constitutes conduct that is prejudicial to the public interest and may lead to disciplinary proceedings by the Registrar. Asking the right questions and following up on certain suspicious or conflicting information obtained in the initial client interview is one way in which mortgage brokers can help to minimize the occurrence of mortgage fraud.

MORTGAGE OPTION RECOMMENDATIONS

Once all of the relevant details have been collected from the client, the next step is to analyze the client's needs and match them with suitable mortgage products. Where there are multiple potential products that might meet the client's needs, the two or three options that the mortgage broker deems most suitable should be presented to the borrower for review.

In preparation for making a mortgage recommendation, the mortgage broker will perform the following actions.

Review the Client's Requirements

The first step entails carefully studying all of the client's responses to the interview questions, such that the mortgage broker fully understands the client's needs. This is where the mortgage broker benefits from having taken clear, detailed notes throughout the initial interview, which serve as a valuable reference in the product recommendation process. Where information is missing, the mortgage broker should contact the client with follow-up questions.

1 Initial Client Interview

2 Mortgage Option Recommendations

- Review the Client's Requirements
- Research Mortgage Options
- Disclose Which Lenders Are Being Compared and Why
- Provide More Than One Option
- Recommend the Most Suitable Option
- Put Recommendations in Writing for the Client
- Clearly Communicate Rates, Limitations, and Fees
- Address Questions and Concerns

3 Taking the Mortgage Application

Research Mortgage Options

Surveys indicate that a primary reason clients choose to employ a mortgage broker is to have a third party undertake professional research to determine the best mortgage alternatives. Despite this fact, research also shows that as much as 90% of the typical mortgage broker's origination volume goes to only three different lenders.[1]

This trend conflicts with client expectations, which are typically that the mortgage broker will compare most – if not all – of the relevant lenders available to the mortgage broker. Clients expect and mortgage brokers are obligated to research all lenders that they have access to, not just those who pay the highest commissions or have the best broker *status programs*.

status programs
programs established by lenders to reward mortgage brokers with incentives for referring large volumes of business

ALERT

Status programs include perks provided to mortgage brokers such as faster turnaround times, deeper rate discounts, larger commissions, trips, marketing dollars, and reward points that can be put towards merchandise. A mortgage broker's recommendation to a borrower to choose a particular lender may be affected if the broker receives a benefit from the lender that is dependent on its volume of business or efficiency ratio of successful mortgages funded by the lender. The acceptance of such benefits constitutes a conflict of interest for the mortgage broker. A conflict of interest exists when a mortgage broker has competing interests between themselves and other parties in the transaction (e.g., the borrower client). While it is not always possible for mortgage brokers to avoid such conflicts, and the existence of a conflict does not necessarily mean that the broker has engaged in any wrongdoing, the MBA (section 17.3) requires that the broker disclose the conflict of interest to the borrower in a Form 10 Conflict of Interest Disclosure Statement.

Lender-paid compensation and perks can and do sway the recommendations of some mortgage brokers and this conflict of interest is a serious concern to the Registrar. The Registrar advises mortgage brokers that all sources and methods of compensation (except compensation received directly from the borrower) must be disclosed to the borrower in the Form 10. Furthermore, all disclosure should be made in a clear and meaningful way so that the borrower is fully able to appreciate the conflict of interest disclosed.

Disclose Which Lenders Are Being Compared and Why

Clients expect that mortgage brokers will compare the products from a wide range of lenders to find the best financing option available to the client; however, many clients are not aware that many of Canada's largest national banks do not participate in the mortgage broker channel.

Mortgage broker disclosures, including the Form 10, were discussed in more detail in **Chapter 2**

A mortgage broker owes their clients disclosure regarding how they are compensated, how many lenders are being researched on the client's behalf, and why the mortgage broker may not compare all potential lenders. Proficient mortgage brokers have a working knowledge of the available products and can readily compare these options on their own. Mortgage broker channel lenders do not always offer the best features and pricing for every single client; for example, a non-broker bank may offer easier approval and/or lower rates to non-resident borrowers or customers with a portfolio of rental properties. While it may be difficult for a mortgage broker to refer a client away in the short term, focusing on the client's best interests will solidify the mortgage broker's reputation, enhance the industry integrity and public's trust, and encourage referrals in the long term.

Provide More Than One Option

Earlier in this chapter, a text box outlined the reasons that clients choose to work with a mortgage broker. The second most important factor was having multiple financing options to choose from. For a mortgage broker, the best practice is to provide at least two or three product alternatives that best match the client's needs and wants.

Recommend the Most Suitable Option

A client relies on the knowledge and advice provided by a mortgage broker relating to the best financing options that are available. Therefore, from the choices a mortgage broker presents to their client, it is appropriate for the mortgage broker to recommend the most suitable option for the client based on their needs. The mortgage broker must be prepared to explain exactly why a particular lender and option is recommended over the alternatives.

Put Recommendations in Writing for the Client

The mortgage broker should document all material factors that contributed to their mortgage recommendation. There are two main reasons for this: first, it helps the client understand why that recommendation was made, thus instilling confidence in it; second, it serves as evidence if the mortgage broker's recommendation is ever brought into question in the future. As with any substantive client communication, a record should be kept on file of the steps leading up to the client's final mortgage product selection.

Recordkeeping was discussed in **Chapter 18**

As a Mortgage Broker...

Remember to include consideration of all aspects of the transaction and to indicate in writing if your recommendation requires additional professional confirmation, such as independent legal or accounting advice regarding any of the features of the mortgage(s) involved.

Clearly Communicate Rates, Limitations, and Fees

The rate and term of the recommended mortgage option must be disclosed to the client, along with any fees that are required to close the mortgage.

It is the mortgage broker's duty pursuant to the MBA and the *Business Practices and Consumer Protection Act* (BPCPA) to outline all material fees that the client can expect to incur when closing their mortgage. This includes appraisal fees, penalties, title insurance, legal fees, broker fees, and discharge fees.

Business Practices and Consumer Protection Act (BPCPA) was discussed in **Chapter 11**

ALERT

The Registrar has received complaints that some mortgage brokers are charging prohibited fees and using coercive practices (including threatening legal action) to induce consumers to pay such fees. Sections 4(3)(b)(ix) and 5 of the BPCPA prohibit mortgage brokers from charging any fees for arranging a consumer mortgage in BC, unless those fees are deducted from the mortgage advance at the time of funding. Examples of prohibited fees include application fees, commitment fees, and cancellation fees. The Registrar treats allegations of coercive practices seriously.

Furthermore, the Registrar expects that mortgage brokers provide consumers with sufficient information to make an informed decision when charging a fee for mortgage broker services. Therefore, an agreement on fees should be reached in advance and be included in a Client Service Agreement or similar agreement.

It is permissible for mortgage brokers and lenders to take sums of money from clients in advance of mortgage funding to cover the actual costs of the mortgage transaction that are paid to third parties, such as legal and appraisal fees, if the client has agreed to compensate the mortgage broker or lender for such costs.

Finally, the Registrar recommends that mortgage brokers seek legal advice relating to compliance with the legislation when charging fees.

Address Questions and Concerns

The best practice for a mortgage broker is to answer all client questions and address all concerns in a calm, understanding, and professional manner. The goal should be to demonstrate to the client that their concerns are being heard, that the mortgage broker is dedicated to resolving the concerns, and that the end goal is to secure the client with the best overall financing package available.

Case Study, continued

You have now assessed Steve and Patricia’s personal circumstances. The key requirements they communicated are the need to eventually move into a bigger house (for their growing family), a desire for the lowest possible payments, a way to deal with the uncertainty of their monthly cash flow (due to reliance on commission, bonus, and self-employment income), and the need for ample prepayments.

With these requirements in mind, you have researched all lender options available to you and have made the following two recommendations:

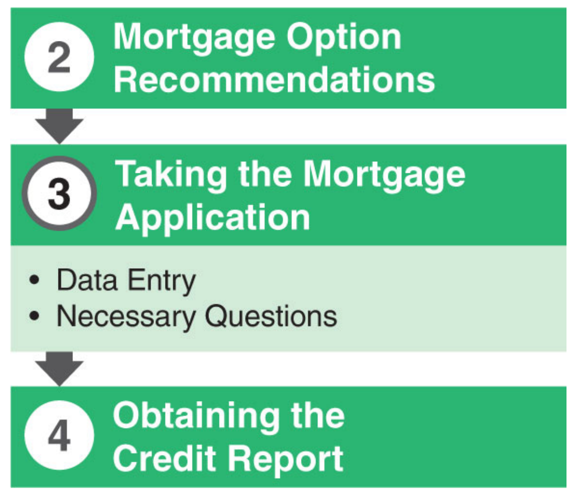
- Option #1: A 5-year fixed at 3.69% with 20% prepayment privileges, 90 days to port the mortgage to a new property, and up to a 30-year amortization

- Option #2: A 4-year fixed at 3.39% with 15% prepayment privileges, 60 days to port the mortgage to a new property, and a 25-year amortization

Despite the stress tests indicating that, with their budget, they can withstand 2.00% higher rates at maturity in four years, Steve and Patricia decide on the 5-year term for the following reasons:

- Bigger prepayment privileges, which lets them use more of Patricia's legal settlement to pay down the mortgage
- 30-year amortization, which minimizes their obligatory monthly payments (understanding that a longer amortization period and lower payment means they will pay more interest)
- Longer term, which provides more rate security

TAKING THE MORTGAGE APPLICATION



Efficient mortgage approvals depend on a mortgage broker's application taking skills. This section contains several best practices to ensure that the application submissions are complete and error-free. Error-free applications will ensure that approvals are obtained in a timely matter and will also eliminate unnecessary back-and-forth contact between the mortgage broker and the lender.

Data Entry

Clients submit mortgage applications in several different ways, including:

- online application forms;
- telephone applications;
- applications by email (e.g., a PDF document); and
- paper applications submitted by fax.

The market is moving towards online applications that automatically pre-populate the client's data into deal submission software (e.g., Filogix Expert, Velocity). Internet applications save a step by avoiding transcription of the application data from the client form to the mortgage broker's software. This reduces the likelihood that transcription errors are made by the mortgage broker on the loan submission form(s). Despite these benefits, online applications do not offer the one-on-one interaction of an application taken by telephone or in person. Many mortgage brokers prefer these more personal methods because they provide an opportunity to answer client questions on the fly, validate data in real-time, and build the client relationship. Furthermore, this personal interaction may provide the opportunity for the mortgage broker to reinstate and demonstrate their value proposition as a mortgage broker, as discussed earlier in this chapter.

Mortgage loan applications were discussed in **Chapter 12** and mortgage broker software in **Chapter 18**

Necessary Questions

The client may not think to completely provide all of the information required in the full mortgage application. In some cases, a client may purposely avoid disclosing certain information. Therefore, it is critical for a mortgage broker to ask detailed questions before submitting a mortgage application to a lender. When pertinent information is left out of an application and/or is provided after the underwriter has already decided upon the financing request, this may raise a concern to the lender. Mortgage brokers have a duty to present mortgage applications in an honest and accurate manner, and misrepresenting any information is conduct prejudicial to the public interest and may be subject to disciplinary proceedings by the Registrar.

Standard mortgage applications require the information listed in the following paragraphs.

Legal Names

The mortgage broker should confirm the legal names of all applicants on the mortgage application. This can be done by asking a client to provide their full name, then comparing the answer to the information provided on government-issued photo identification. Next, the mortgage broker must confirm that each applicant will be on title, a common requirement from lenders. If this is not the case, confirm that the lender will allow the client to be a guarantor and still use their income to qualify the application.

Case Study, continued

While reviewing Steven and Patricia's mortgage application, you discover that Patricia's ID contains her maiden name, which differs from the last name used on her application. As a result, you ask for a copy of her marriage certification, anticipating correctly that the lender will require this.

Address History

Nearly all lenders require a three-year address history for each application. The mortgage broker can confirm this information while going over the application details with the client.

Employment History

In most circumstances, the lender will require a three-year employment history. Exceptions may be made when an applicant has just completed post-secondary education or is at the end of an extended sick or parental leave. This information will be verified using the client's income documentation and during the underwriter's employment verification process.

Income Type

Unless the application is for an *equity mortgage* (i.e., a mortgage based more on a person's equity in the property rather than on detailed income validation), the client's compensation must be reasonably proven. The mortgage broker should always confirm exactly how each applicant is paid and inform the client of the documentation required for that particular income type, as stipulated by the lender. Documentation requirements vary by lender, especially when it comes to commission income, dividend income, contract income, part-time income, bonus income, retirement income, and other non-routine income types. Examples of income documents include pay statements, NOAs, T4s, tax returns, financial statements, and bank statements.

equity mortgage
a mortgage based more on a person's equity in the property rather than on detailed income validation

Case Study, continued

Since you need to prove Steve's bonus to qualify him for the mortgage, you ask him to provide his NOAs for the last two years. You then calculate the two-year average of the Line 150 amount from each NOA. This is a common method of proving bonus income; however, lender policies may differ.

Details on Any Current Properties

A client who owns more than two to five additional properties may not qualify with certain lenders due to the portfolio risk guidelines of those lenders. A mortgage broker must always confirm how many other properties the client owns throughout the world, either directly or indirectly (e.g., through a corporation). Any properties that the client has financed and/or personally guaranteed should be disclosed in the mortgage application.

ALERT

In one recent disciplinary case, a submortgage broker was found to have conducted business in a manner that was prejudicial to the public interest when, on behalf of six borrowers, he failed to investigate whether the borrowers owned other properties in addition to the properties disclosed in mortgage applications when he knew or ought to have known that the borrowers owned other properties. The submortgage broker agreed to pay an administrative penalty of $13,000 and partial investigation costs of $1,000.

Source: *www.bcfsa.ca/media/236/download*

Details on Any Current Mortgages

The mortgage broker must always confirm the payment amounts, payment frequency, interest rate, outstanding balance, amortization, lender name, and maturity date of any outstanding mortgages that the client may have.

In addition, the mortgage broker should inquire as to whether the current mortgage is insured. If the current mortgage is insured, it is a good idea to maintain default mortgage insurance when switching lenders. Doing so gives the client more lender options if they need to renegotiate the mortgage in the future. This is because lenders prefer insured mortgages as they are deemed less risky; in turn, this means they often have lower interest rates.

Finally, the mortgage broker should ask if the client has any secondary financing secured against their properties, such as a line of credit or a second (or third) mortgage. If so, and if the client is refinancing, secondary mortgages will need to be paid out and closed, refinanced into the new first mortgage, or "postponed" behind the new lender's first mortgage.

ALERT

In addition to obtaining information relating to any current and outstanding mortgages of the borrower, a mortgage broker must also inquire whether the borrower has submitted any other applications for concurrent financing, and if so, disclose this on the mortgage application that the broker submits to lenders. A failure to disclose this is considered to be application fraud and can invite disciplinary proceedings against the mortgage broker.

In one particular disciplinary proceeding, a submortgage broker was found to have committed conduct prejudicial to the public interest when he, among other things, submitted several mortgage applications to lenders without disclosing that the client was concurrently seeking financing to purchase other properties. The submortgage broker agreed to pay an administrative penalty of $25,000 and investigation costs of $10,000, among other penalties.

Source: *www.bcfsa.ca/media/225/download*

Details on the Subject Property

It is prudent for the mortgage broker to confirm the *parcel identifier* (PID), legal description, and street address of the property, as well as expected property taxes, heating and utility costs, and strata fees (if applicable). In British Columbia, the PID and legal description can be found on the state of title certificate, obtained through the Land Title and Survey Authority of British Columbia (online at myLTSA). If the PID is not available, a search can be performed through BC Assessment using the civic address of the property, which will ultimately provide the PID. With respect to property taxes, tax certificates showing the expected property taxes (and whether taxes are owing) can be obtained from the municipality directly or online through myLTSA (for many municipalities). If the financing being sought is for the purchase of a property, mortgage brokers should also inquire as to whether the sale is a result of an MLS® listing or is a private sale because different lenders have different underwriting policies with respect to private sales. For example, with private sales, lenders will almost certainly require an appraisal (rather than relying on an AVM).

parcel identifier
nine-digit number that identifies property in BC

Title registration in British Columbia was discussed in **Chapter 4**

Automated Valuation Models (AVMs) were discussed in **Chapter 15**

Case Study, continued

You ask Steve and Patricia for the estimated property taxes of their new property. They reply that they are not sure. You ask them to check the real estate agent's copy of the MLS® listing of the property, which generally shows this information.

Requested Mortgage Terms

The mortgage broker must confirm with the client the term, amortization, interest rate, and any non-standard requests that are related to the mortgage.

Qualification Rate and Amortization

As mentioned earlier, risk tolerance and stress-testing are very important. For the purposes of calculating debt serviceability, all mortgages are required to qualify at the *qualifying rate* (the greater of the Bank of Canada benchmark rate or an additional 2% above the mortgage's negotiated contract rate). In addition, all high-ratio insured mortgages and many secured lines of credit must be qualified using a 25-year amortization period (or less).

qualifying rate
the greater of either the Bank of Canada benchmark rate or the contractual mortgage rate plus 2%

Closing Costs

Closing costs include property transfer tax, mortgage registration and administration fees, legal and conveyance fees, etc. The mortgage broker should verify that the client is aware of all closing costs and is able to pay them out of pocket. The mortgage broker must also document the source of these funds in their notes to the lender. The general rule of thumb for lenders on purchases, especially where the down payment is less than 20%, is that the client should be able to prove that they have 1.5% of the property value available in cash to cover potential closing costs.

Closing costs and statements of adjustment were discussed in **Chapter 20**

Other Considerations

Additional key questions that the mortgage broker should ask the client when validating application data include the following:

- If the mortgage is a refinance, what are the fees and penalties (if any) that the client will face if they leave the existing lender?
- Does the client have any other live applications with other lenders or mortgage brokers at this time? If so, is there a fee or penalty to cancel the application with that lender or mortgage broker?
- Are there any defects in the property that could possibly affect its marketability (e.g., mould, knob and tube wiring, lead paint, asbestos insulation, a damaged foundation, underground oil storage tanks, well water problems)?
- Will any portion of the property be rented at any time during the term? Note that many lenders offering owner-occupied mortgages prohibit non-owner-occupied rental units. In cases where rental income is allowed, the lender may require that the suite/unit conform to municipal zoning bylaws and fire codes.

As a Mortgage Broker...

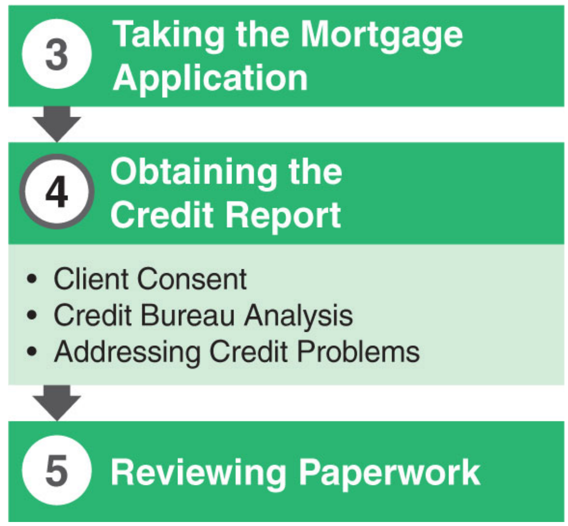
Mortgage brokers should always ask the following "catchall" question: "Is there anything else that we haven't discussed that the lender might need to know about when assessing the risk of your application?"

In addition to validating application data, the mortgage broker should provide notifications to the client to prepare them for the next steps with the application. For example, the client should be notified that:

- seeking additional credit, changing employment, and/or incurring additional debt before closing could jeopardize their approval;
- missing any existing mortgage or credit payments before closing could jeopardize their approval;

- their employer may be contacted and may require the client's authorization to release employment history to the lender or mortgage broker; and
- a full appraisal may need to be done on the subject property (which may require scheduling access to the property).

OBTAINING THE CREDIT REPORT



Once the application is complete, the next step is to pull the applicant's credit report. This is typically obtained electronically via the mortgage broker's origination software. The most commonly used credit report is from Equifax, but many lenders also accept TransUnion.

There are several factors that mortgage brokers should keep in mind when obtaining the credit report, detailed in the following sections.

Client Consent

Both the law and Canada's credit bureaus require a mortgage broker to obtain explicit consent from the client before the mortgage broker requests a credit report on the client. If the mortgage broker is requesting a credit report on more than one client, each client must provide consent. This consent must be in writing and the mortgage broker should re-obtain consent each time they request a new credit report. As discussed earlier, one way in which the Registrar recommends obtaining this consent is through a signed Client Services Agreement and Authorization. Note that lenders often do not accept credit reports that are over 30 days old.

Credit reports and their analysis were described in **Chapter 12**

Federal and provincial law requires mortgage brokers to respect the confidentiality of personal client data. Releasing such sensitive information to any other party without the client's consent is against the law; even personal information disclosures made to the client's family or real estate sales representative are a violation, without obtaining proper consent. BC's *Personal Information Protection Ac*t contains a number of situations in which an organization may disclose the personal information of an individual without that individual's consent, one being the disclosure to a public body in the course of an investigation or inquiry. The Registrar has the legislated authority (section 6 of the MBA) to require mortgage brokers to produce records for inspection, examination, and analysis in the course of investigating a breach of the MBA or MBA Regulations. Whenever a mortgage broker is faced with a request to disclose an individual's personal information without consent, the broker is advised to seek legal advice.

The *Personal Information Protection Act* was discussed in **Chapter 18**

Credit Report Analysis

When reviewing a credit report, there are two general goals. The first is to confirm whether the client has (or has had) any delinquencies or judgments, and the second is to confirm the exact amount of the client's liabilities (e.g., credit card, loan, and credit line balances), where accuracy is required for the debt-ratio analysis.

With respect to the first goal, in the application notes to the lender, the mortgage broker must explain any late payments revealed in the credit report. If *severely derogatory* items are present on the credit report, this may require submission to a different lender or remediation of the client's credit. Some lenders will decline a file if it has payments that are more than 30 days late in the last one to two years; others will allow a few such occurrences. The mortgage broker should know the lender's policy prior to submitting an application.

severely derogatory
negative records on the credit report that can damage one's credit score

Case Study, continued

Your review of Patricia's credit report reveals an unexpected problem: a collection from her cell phone company. Patricia states that she was only five weeks late on the final payment when she cancelled her cell phone, but the phone company improperly wrote off her account as a collection.

This oversight has lowered her score by 80 points. Fortunately, her credit score is still above the lender's minimum. Nonetheless, you want to help her out. Since she has already paid the bill in full, you suggest she contact the cell phone company to request that they report a correction to the credit bureau, changing its rating from an "O9" (collection) to an "O3" (31-60 days late). That should improve her score significantly once the phone company reports to the credit bureau, which can take up to 30 days.

With respect to the second goal of confirming the client's liabilities, the mortgage broker must determine that the payments for all liabilities are precise. Lenders generally use 3-5% of the balance (and in some cases the credit limit) on unsecured credit when determining payments for calculating total debt service, and the client's application should reflect this.

Addressing Credit Problems

Late payments and poor credit scores can be improved upon and corrected with time and effort. If the client's credit report is weak (e.g., a credit score under 620 and/or includes severely late or written off payments), they will usually need to secure financing with a non-prime lender. Usually, the client will only need a non-prime solution for one to two years, until their credit is strong enough to apply with a prime lender such as a bank, credit union, or monoline.

Mortgage brokers commonly advise clients on the topic of *credit repair*. Routine strategies to repair one's credit include:

- paying off delinquent debts or bringing late payments up-to-date;
- paying down over-limit credit accounts;
- reducing credit utilization on all unsecured accounts to below 65-70% of the credit limit;
- getting a secured credit card or secured loan with at least a $2,000 limit and making regular payments on it;
- avoiding applications for new credit;

- correcting inaccuracies on the credit report; and
- avoiding the closure of old inactive accounts. Credit scores are based partly on the ratio of available credit that is being utilized. Closing accounts can raise credit utilization and hurt the client's score.

credit repair
the process of improving a poor credit

REVIEWING PAPERWORK

What a client reports and what can actually be proven are two different things; this is why proper documentation is essential. The mortgage broker must scrutinize client-provided paperwork to ensure that the client meets lender guidelines. This will also protect the lender from the risk of fraud. The following sections outline the process of reviewing paperwork.

ALERT

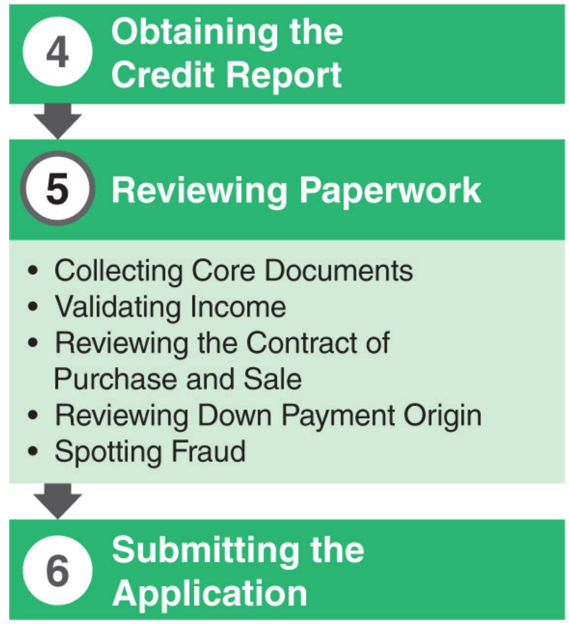
The Registrar receives numerous complaints from lenders that have received misleading or false information in a mortgage application. Application fraud is a significant concern to the Registrar. Application fraud can occur when a mortgage broker fails to verify client information that is being passed on to lenders. Mortgage brokers need to recognize that lenders rely on the information they receive regarding potential borrowers. Mortgage brokers cannot say that it is not their responsibility to verify the information being given to them during the application process. The Registrar takes the position that a mortgage broker has a duty to ensure that the information being sent to a lender has been verified. If a mortgage broker does not verify certain information being forwarded to the lender, they should advise the lender accordingly.

Although it is not suggested that mortgage brokers need to conduct in-depth investigations of every transaction that they process, reasonable due diligence must be undertaken to ensure that the information being passed on to a lender is accurate. Applications containing errors or omissions need additional verification and under no circumstances should brokers be referring applications that have been shown by another mortgage broker or lender to contain false or inaccurate information.

Collecting Core Documents

Unless an application is time-sensitive and the client's income is straightforward and can easily be proven, it is best practice for the mortgage broker to review the client's core documentation before submitting the application to the lender for approval. This includes all paperwork required to prove income and employment tenure, the source of the down payment, and the contract of purchase and sale (if the mortgage is for a property purchase).

Validating Income



Before sending an application to a lender, the mortgage broker should confirm that the income reported on the client's income documents corresponds to the income that they have claimed in the application. This often requires a simple calculation to confirm if the year-to-date income projects out to the full-year compensation claimed in the client's application. Income should be reasonable for the borrower's occupation. If the mortgage broker feels the income might be too high, there is a good chance that the lender will feel the same way.

Case Study, continued

Steve sends you a pay stub but you notice it is two months old. Since lenders generally want pay stubs that are 30 days old or less, you ask him for his most recent one.

Reviewing the Contract of Purchase and Sale

Contracts of purchase and sale have many pieces of information that are important to the purchase, including the purchase price, deposit, closing date, conditions precedent (subject-to clauses), subject removal deadline(s), purchaser names, and property address. This information should always be cross-referenced with the application to ensure accuracy. The mortgage broker must ensure that all signature lines on the contract of purchase and sale are completed and dated, including witness signatures. In addition, all relevant schedules and addenda must be complete and provided to the lender.

Non-arm's length transactions and private sales must be disclosed in the mortgage broker's application notes to the lender because they are often subject to special underwriting rules, including stricter appraisal requirements, mandatory default insurance, and rate premiums. See the "Making Detailed Application Notes" section below.

non-arm's length transaction
generally speaking, a transaction between parties that have a pre-existing relationship with one another (e.g., family members, business partners)

Reviewing Down Payment Origin

If the mortgage is for a property purchase, the mortgage broker needs to confirm the source of every dollar of the down payment funds. Any funds that are not from the client's own savings and have not been in the client's possession for at least three months must be explained to the lender. Borrowed or gifted down payments are subject to specific lender and insurer guidelines.

Case Study, continued

Steve and Patricia's chequing account statement reveals a large deposit of $10,000 one month ago. Knowing that lenders routinely question large deposits (to comply with banking regulations), you ask for clarification on this transaction. Patricia explains that it was an inheritance from an aunt who recently passed away, but that she is not using it for her down payment. You record this in the application notes for the lender.

Spotting Fraud

Mortgage fraud is a significant problem and the mortgage broker is the front line of defence to protect the lender from fraud. If a mortgage broker lacks awareness on the topic of mortgage fraud, it may hinder their reputation with mortgage lenders. Furthermore, it can tarnish the reputation mortgage brokers have with the general public and within the lending community.

Mortgage fraud, due diligence, and red flags were described in **Chapter 5**

It is the mortgage broker's responsibility to be familiar with the prevalent types of mortgage fraud discussed in Chapter 5 and to spot and investigate factors such as:

- discrepancies between the application address(es), the address(es) on file at the credit bureau, and the address(es) listed on the applicant's credit report;
- identification or documentation that is illegible or that displays imperfect positioning of text or images;
- assets and debts that are not consistent with the client's age and income;
- income that is too high for the type of employment;
- the same phone number for the borrower and the employer;
- void cheques that are not personalized; and
- large unexplained lump-sum deposits in bank or investment statements.

If a client is unable to provide a satisfactory explanation for the inconsistencies spotted by the mortgage broker, the application should not be submitted to the lender.

ALERT

In November 2004, the Registrar issued an open letter and amended the rules for mortgage brokers surrounding verification of information provided to lenders. The concern arose out of the impact of marijuana grow operations on property values. The Registrar noted that mortgages were being obtained on properties using fictitious purchasers and/or false employment and down payment information in the application. The Registrar found that in a significant number of transactions, little, if any, due diligence had been carried out to ensure the accuracy of the information provided in the mortgage application. The Registrar reminded mortgage brokers that they have a responsibility to ensure the accuracy of the information provided by the applicant.

The early detection and reporting of fraudulent mortgage applications is an essential tool in combating the problem of fraudulent mortgage transactions and money laundering, and mortgage brokers are encouraged to report suspected cases to the authorities as soon as possible.

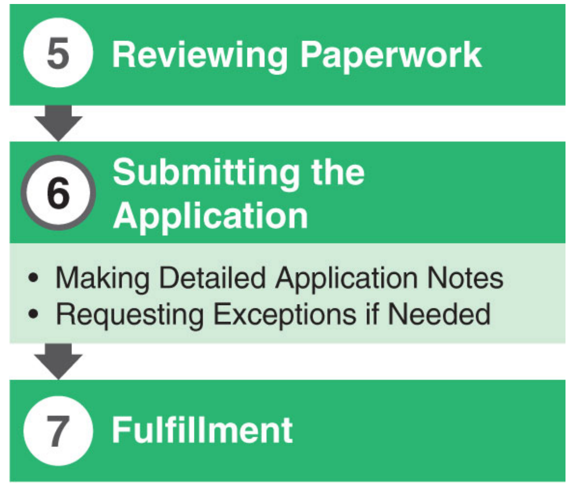
Furthermore, it goes without saying that mortgage brokers should neither encourage their clients to provide false information on a mortgage application nor participate in the application fraud themselves. Application fraud is a serious concern to the Registrar and it will not hesitate to investigate complaints of such conduct, which could lead to disciplinary proceedings.

In one recent disciplinary case, a submortgage broker was found to have conducted business in a manner prejudicial to the public interest when he altered borrowers' Canada Revenue Agency documents and presented them to lenders as part of mortgage applications, thereby misrepresenting the income of the borrowers. The broker, unregistered at the time of the disciplinary proceeding, was prohibited from applying for registration as a submortgage broker for a period of 10 years and was required to pay partial investigative costs of $4,000.

Source: *www.bcfsa.ca/media/240/download*

SUBMITTING THE APPLICATION

Once the client's application is fully validated, it may then be submitted to the lender. The mortgage broker should take detailed application notes and request exceptions, if needed.



Making Detailed Application Notes

Every application that the mortgage broker submits to the lender should have clear and comprehensive application (or deal) notes presented in easy-to-read point form. These notes should confirm the closing date, type of mortgage being requested, rate being requested, source of business, confirmation of the client's consent to review their credit, rate buy-downs (if applicable), disclosures that could potentially impact the risk of the application, and any other notes that could help eliminate ambiguity.

Requesting Exceptions if Needed

All exceptions to lender policies should be documented in the application. If the mortgage broker is requesting an exception on behalf of their client, the best practice is to contact the lender's business development manager (BDM) and get their approval before submitting the deal to the underwriter. The BDM's response to the exception request should be noted in the application notes. Unless the client is an extremely strong borrower (i.e., with good credit, provable income, reasonable debt ratios), it is unlikely that the mortgage broker will be able to get more than one exception on the same application.

Case Study, continued

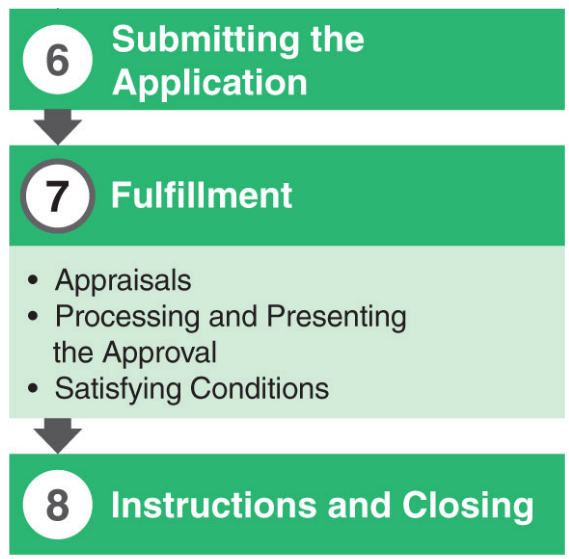
Patricia's credit score is just below the 690 minimum required by the lender of her choice. Since the application is primarily dependent on Steve's larger income and since their application is otherwise within lender guidelines, you decide to ask the lender for this small exception to its 690 minimum credit score. You first request the exception from the BDM. The BDM confirms that it is possible, subject to review of the full application. You then document this exception request and the BDM's response in the deal notes and submit the file for approval.

FULFILLMENT

Once an application is submitted for approval, the following steps must be undertaken to close the mortgage in a timely and efficient manner.

Property appraisal was introduced in **Chapters 15** and **16**

Appraisals



All mortgages require valuation of the lender's security (i.e., the subject property). This can be in the form of an in-person appraisal or an electronic automated valuation.

Types of Valuation

When a mortgage is insured, its subject property is analyzed automatically by the insurer's risk assessment system. CMHC's emili is the most common system, followed by Sagen's™ (formerly known as Genworth Financial Canada's) Excel. If the mortgage is uninsured, lenders typically require an in-person appraisal. These are most often ordered through a lender-approved appraisal management firm. Alternatively, some lenders allow mortgage brokers to choose their own appraiser from an approved list.

Lenders are increasingly using in-house Automated Valuation Systems (AVSs) or AVMs for faster service on conventional mortgages. When these tools reveal a potential valuation concern, the lender or insurer will then dispatch an actual appraiser to the property.

In cases where an appraisal is required but the client has a tight timeframe to remove financing subjects, that appraisal should be ordered on or before the time of application.

Solving Appraisal Problems

Appraisers are skilled at what they do; however, the process of appraisal is somewhat subjective and is not an exact science. Occasionally, appraisers value properties below what could be deemed a reasonable lending value, causing the client's application to be declined. The mortgage broker can always challenge a property appraisal if they know that more suitable comparable properties exist.

To begin this process, the mortgage broker should know the lender's appraisal guidelines and ensure the alternate comparables that the mortgage broker finds are in line with those guidelines. The mortgage broker can then present those alternative comparables to the appraiser and ask them to review the properties. If the appraiser then revises the valuation in the client's favour, the mortgage broker can present this re-appraisal to the lender's underwriter for further review. However, market value and lending value are two different concepts, and lenders often have specific valuation guidelines for appraisers. Those guidelines may ultimately result in the lending value being more conservative than the true market value.

Processing the Approval

Upon approval, the mortgage broker must carefully review the lender's commitment to ensure that it matches the client's expectations with respect to rate, closing date, and terms. Errors should be corrected before the approval is presented to the client.

Presenting the Approval

When the mortgage broker presents an approval to the client, the best practice is to send it with a complete approval package. The approval package should have the lender's commitment plus all required provincial disclosures and consent forms.

The BPCPA and Annual Percentage Rate disclosure requirements were discussed in **Chapter 11**

The mortgage broker must ensure that every page of the approval package is accurate and clearly guides the client through each section. It should highlight areas to sign and include full disclosure of all unusual or materially adverse terms, restrictions, potentially confusing lender conditions, conflicts of interest, and lender or broker fees required to close the mortgage. Examples of items that may require extra disclosure include:

- higher than normal penalties;
- refinancing restrictions;
- lender prohibitions on renting out the property; and
- restrictions on porting the mortgage to a new property.

A growing trend in the industry is electronic document signing (e-signing). E-signing can be safer, faster, and more convenient for clients compared to reading, signing in ink, and manually faxing or scanning and emailing. Most lenders now accept e-signed approval packages from reputable technology vendors (e.g., Adobe). However, the final mortgage documents, including all Land Title Office registration documents, must still generally be signed in ink in front of a lawyer or notary.

E-signatures were discussed in **Chapter 18**

Regulatory Disclosures

Adhering to the regulatory requirements for disclosure should be of primary importance when presenting the approval. The overall purpose of disclosure is to provide material, clear, and meaningful disclosure to the appropriate party so that they can make an informed decision on whether and how to proceed in the mortgage transaction. For example, section 67 of the BPCPA states that a credit grantor who is required to give a disclosure statement or statement of account under Part 5 of the BPCPA must ensure that the statement "prominently displays (the required) information in a clear and comprehensible manner."

Disclosure requirements under the BPCPA and MBA were discussed in detail in **Chapter 2**

The following are the most common regulatory disclosure forms that a mortgage broker may be required to provide:

- **Under the BPCPA:** a Disclosure Statement, Notice, or Statement of Account (under Part 5); and
- **Under the MBA:**
  - Form 9 – Disclosure to Mortgage Lenders (pursuant to section 17.1);
  - Form 10 – Borrower and Lender Conflict of Interest Disclosure (pursuant to sections 17.3 and 17.4).

Satisfying Conditions

Lenders expect the mortgage broker to satisfy lending conditions as soon as is practical. As such, documentation should be collected from the client at the earliest opportunity and sent to the lender. This also gives the mortgage broker more time to address any lender concerns with the submitted documents. Lenders typically review submitted documents within a few business days and then send out tick sheets that list outstanding conditions.

The most time-consuming elements of the conditions review process are often employment verification (due to underwriters and employers frequently missing each other's phone calls and being forced to leave voicemails) and the appraisal (due to the time it takes to schedule appointments, visit the property, prepare the report, and have it reviewed by the lender).

When all conditions of the mortgage commitment are satisfied, the lender will issue a written "file complete" notification. A mortgage broker should instruct the borrower that, until all lender requirements are met and signed off (i.e., approved) by the lender, the mortgage application is not fully approved; therefore, the borrower should not remove subject clauses or conditions in the contract of purchase and sale at an earlier point in time. As always, a mortgage broker's advice to their client should be documented in writing and included in the client's file. This can prove to be extremely helpful in the event that a purchase transaction falls through due to financing issues and the client seeks to place unwarranted blame on the mortgage broker.

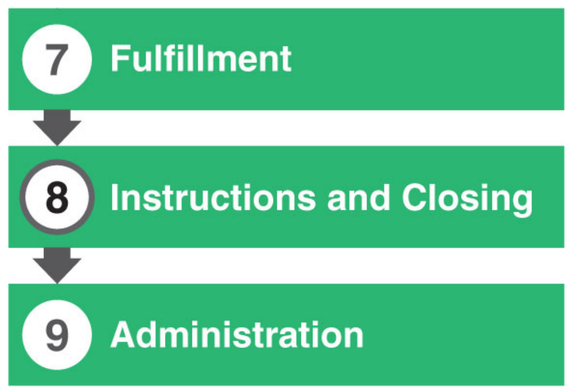
As a Mortgage Broker...

It is fairly common for a client's real estate agent/representative or family members to inquire with the mortgage broker about the status of the client's approval. You must have the client's explicit consent on record before disclosing any such information to another party. It is imperative that the mortgage broker respects the client's right to privacy and protection of personal information, as required by the *Personal Information Protection Act* (PIPA). PIPA was discussed in Chapter 18.

Case Study, continued

Steve and Patricia have provided all documents requested by the lender. The lender has signed off on everything and instructed the lawyer to close. Now, barring any unexpected issues, everything should be in the lawyer's hands.

INSTRUCTIONS AND CLOSING



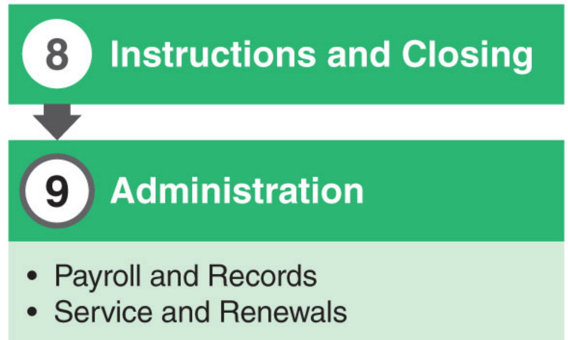
Once a file is complete, the lender will instruct the lawyer or notary to register and close the mortgage. Mortgage instructions are not typically sent to the mortgage broker. Therefore, the best practice for the mortgage broker is to promptly confirm receipt of these instructions by the party closing the mortgage. The mortgage broker should verify that the lawyer or notary sees no errors that could delay the process. As well, the mortgage broker should instruct the lawyer or notary closing the mortgage to notify them immediately if there are any problems that cannot be resolved quickly. The mortgage broker should also make sure that the mortgage transfer will close in time and if there appears to be a delay, the situation should be dealt with immediately.

Case Study, continued

It has been a long road, but Steve and Patricia have now signed the registration documents at their lawyer's office. The lawyer has requested the mortgage funds from the lender, confirmed that those funds are in the lawyer's trust account, and registered the mortgage. The keys to their new house will be in Steve and Patricia's hands by the morning.

ADMINISTRATION

Payroll and Records



Once a mortgage is closed, the lender pays the mortgage brokerage. Although not required by law, the best practice is for compensation to be paid only after the client's paperwork has been reviewed by a compliance officer and properly archived. A compliance officer can work full or part time in this capacity, depending on the firm. The compliance officer reviews broker application packages to ensure they meet disclosure requirements, sets compliance policies, processes mortgage broker re-licensing, writes compliance procedures, and monitors brokers to ensure they adhere to the wide range of industry regulations.

Ideally, a compliance officer functions independently of sub-mortgage brokers to minimize conflicts of interest. They may work for the brokerage that the mortgage broker is affiliated with, or the mortgage broker's firm may outsource this role to a third-party compliance professional.

ALERT

According to the MBA, any individual who arranges a mortgage or mortgages and either directly or indirectly receives fees or any other consideration exceeding $1,000 in any one year for arranging a mortgage or mortgages must be registered under the MBA.

Effective record keeping is an important part of a mortgage broker's practice once the file has closed. For example, section 17.2 of the MBA states that mortgage brokers must retain copies of the Form 9 (Disclosure to Mortgage Lenders) for at least seven years. Similarly, section 17.5 of the MBA states that mortgage brokers must retain copies of the Form 10 (Borrower Conflict of Interest Disclosure) and Form 11 (Lender Conflict of Interest Disclosure) for at least seven years.

In addition to sections 17.2 and 17.5 of the MBA, the MBA Regulations contain additional record keeping obligations. Section 6 states the following:

Statements and records

6 Every registered mortgage broker shall

a. keep such books and records as necessary for the proper recording of his business transactions and financial affairs,
b. file with the registrar, at the time of application to be registered and thereafter annually and at other times that the registrar may require, financial reports
   i. in a form satisfactory to the registrar,
   ii. in a form certified by the mortgage broker, or by a director or partner of the mortgage broker, and
   iii. if required by the registrar and if he or she considers it warranted in the particular circumstances, reported on by auditors engaged by the mortgage broker,
c. file with the registrar the other information that the registrar may require in the form that the registrar may specify,
d. keep and maintain a record showing
   i. the repayment terms of each mortgage,
   ii. the total amount actually paid or to be paid to the mortgagor of each mortgage, and
   iii. the fees, expenses, costs and other charges required to be borne by the mortgagor in respect of each mortgage transaction, and
e. keep and maintain up to date trust records in connection with his business to record
   i. all trust money received by him,
   ii. all disbursements of trust money made by him, and
   iii. the unexpended balance of trust money held by him in total and separately for each person for whom that money is held.

Finally, under section 6 of the MBA, the Registrar has the authority to enter the business premises of a mortgage broker for the purpose of carrying out an inspection, examination, or analysis of records, property, etc. that may reasonably relate to the subject matter of its investigation. The Registrar may also require the production of various records and may remove such records for further inspection, examination, or analysis.

Service and Renewals

A mortgage broker should touch base with a client after closing to answer any questions and follow-up on the mortgage process. As well, mortgage brokers should reach out to a client before the client's mortgage's maturity date to ask if help is needed during the renewal process.

CONCLUSION

This summary of a mortgage transaction provides a sense of the effort involved in placing and servicing a client's mortgage. However, this overview merely serves as an example and a high-level analysis. New mortgage brokers owe it to themselves and their clients to get proper mentorship in their early days in the business. The mortgage industry is complex and new brokers often do not realize what they do not know. That is why an experienced mortgage broker – one who reviews the new broker's mortgage recommendations, vets applications before submission, verifies approval packages, and reviews compliance packages – is invaluable. Mortgage brokers who encourage their clients to provide false information on a mortgage application or participate in the application fraud themselves may end up being investigated by the Registrar, which could result in a suspension or cancellation of their licence.

1 Maritz Research, 2011.