SUBMISSIONS

TO THE

ETHICS COMMITTEE OF THE LAW SOCIETY OF BRITISH COLUMBIA

ON

ACTING FOR REAL PROPERTY LENDERS ON SIMPLE CONVEYANCES

AND THE

BC CODE APPENDIX C

Issued By:

Solicitors' Practice Issues Committee of the
Canadian Bar Association
British Columbia Branch

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PREFACE

Formed in 1896, the purpose of the Canadian Bar Association (British Columbia Branch) (the "CBABC") is to:

- enhance the professional and commercial interests of our members;
- provide personal and professional development and support for our members;
- protect the independence of the judiciary and the Bar;
- promote access to justice;
- promote fair justice systems and practical and effective law reform; and
- promote equality in the legal profession and eliminate discrimination.

The CBA nationally represents approximately 39,000 members and the British Columbia Branch itself has over 6,400 members. Our members practice law in many different areas. The CBABC has established 78 different sections to provide a focus for lawyers who practice in similar areas to participate in continuing legal education, research and law reform. The CBABC has also established standing committees and special committees from time to time.

The CBABC Solicitors' Practice Issues Committee is a standing committee of the CBABC ("the Committee"). The purpose of the Committee is to identify, monitor and analyze issues of significance to solicitors' practice, and to make recommendations for actions to be taken to address these issues.

The Committee is composed of the following members:

- Denese Caroline Espeut-Post**,** Chair;
- Kristin R. A. Marrs, Vice-Chair;
- Naseem Bawa;
- Antoine S. Gariepy;
- Juhi Shukla, Secretary; and
- Alison Oxtoby, Executive Liaison.

The comments expressed in this submission reflect the views of the Committee only and are not necessarily the views of the CBABC as a whole.

EXECUTIVE SUMMARY

The Committee's comments were sought by Jack Olsen, on behalf of the Ethics Committee of the Law Society of British Columbia, in March 2015, in connection with the changes to the Code of Professional Conduct for British Columbia (the "BC Code") approved in December 2104 and then rescinded in January 2015. The changes encompassed certain definitions for lenders relating to the "simple conveyance" exception to conflicts of interest and representation of lenders/borrowers in the same transaction.

It is the Committee's understanding that the concern on the part of the Ethics Committee relates to risks that may arise from private mortgage transactions (i.e. penalties, brokerage fees, discounts). However, in narrowing the definition of the type of lender, the Committee's position is that this may unfairly preclude solicitors from acting for the monoline lenders and life insurance company lenders which make up a large part of solicitors' mortgage transactions. On the other hand, the Ethics Committee is endeavouring to set clear parameters surrounding the risks that are associated with mortgage loans that are, arguably, in a different category, that: 1) do not involve what may be seen as competitive rates or usual prepayment privileges, 2) may have onerous terms, 3) may be offered by lenders having strict enforcement policies that are prejudicial to borrowers or 4) may have vulnerable clients may be the "audience" for these products. That is a category of lending where special attention must be placed to ensure that the individual client's interest is not compromised in favour of the lender. Arguably, this type of lending sits at the end of a broad spectrum where the interest of the borrower and lender are significantly different and nowhere near an "equal" bargain.

The Committee's opinion is that there must be a balance struck in assessing any change to the rule, one where clients' interests are paramount, where the protections built in through our BC

Code to ensure that conflicts are identified are buttressed but where solicitors are not put at a disadvantage to their competitors and clients are not put to unnecessary costs in completing what for many in our communities is a routine transaction.

The Committee canvassed members of the BC Bar and discussed the matter at some length in coming to the commentary set out herein. The Committee favours an outcome that ensures that the definition is not exhaustive but one with some flexibility so as to encompass the monoline lenders and life insurance company lenders that are now emerging to a greater extent. However, that said, the Committee sees the Ethics Committee's task of addressing the "vagueness" or "outdated" definition in use as needing some limiting framework so as to ensure that situations of conflict (i.e. situations of differing power, eligibility, vulnerability) are identified and solicitors are precluded from then acting for both sides. As addressed in other jurisdictions (i.e. UK Practice Note 3 March 2015 Conflicts of Interest), a framework that envisages solicitors identifying conflicts by assessing whether the conflict is peripheral to the common purpose or whether it is paramount, and addressing what a "substantially common interest" means as opposed to a strict rule, may add a component of assessment to the situation that is worthy of consideration.

The Committee recommends broader wording permitting joint representation of an institutional lender which permits mortgages "given by a mortgagor to an institutional lender such as bank, trust company, life insurance company or credit union" is appropriate. Exclusion wording for mortgages given by mortgage brokers (which are effectively "private mortgages") may also be considered.

SUBMISSIONS

BACKGROUND

In December 2014, the Benchers of the Law Society passed changes to Commentary 1(d) and Commentary 2(o) in section 4 of Appendix C (Real Property Transactions) to the Code of Professional Conduct for British Columbia (the "BC Code").[1]

Commentary 1(d) of section 4 deleted "institutional lender" and replaced it with "bank, trust company or credit union". Commentary 2(o) which reads as follows was added: "(o) a mortgage given by a mortgagor to a mortgagee that is not a bank, trust company or credit union."

In passing the above-noted changes to the BC Code, the Benchers relied upon a Memo prepared by The Law Society of British Columbia Ethics Committee dated November 4, 2014 which recommended the amendments to the BC Code. According to this Memo, the Ethics Committee opined that the then-language of the BC Code was ambiguous on the question of whether a lawyer can act for a borrower and a lender in non-institutional mortgage transactions. It was the position of the Ethics Committee that "it is undesirable for a lawyer to act for multiple parties in preparing a mortgage when the mortgagor is not an institutional lender." The Ethics Committee expressed concern about the risk of mischief in private mortgage transactions "including prepayment penalties, brokerage fees and discounts up front from mortgage proceeds"; each of which favored separate representation. The Ethics Committee recommended "institutional lender" be defined to include only "banks, trust companies and credit unions" and not include mortgage brokers which "could consist of one person or a one-

[1] https://www.lawsociety.bc.ca/docs/publications/mm/BC-Code_2015-03.pdf

person company... [who] can lend his or her own money and qualifies to carry on business on receiving a very small amount of money and with a very small number of transactions."

In the Benchers' January 30, 2015 meeting, the Benchers rescinded these changes to Commentary 1(d) and Commentary 2(o) in section 4 of Appendix C to the BC Code.[2]

In making the decision to rescind the amendments, the Benchers relied upon a second Memo prepared by the Ethics Committee dated December 29, 2014. This Memo noted that numerous objections centering on the position that Life Insurance Companies and "monoline" institutional lenders should be included with "banks, credit unions and trust companies" were raised by lawyers regarding the amendments. The Ethics Committee also noted a similar objection was raised in relation to mortgage investment corporations. The Memo recommended that the amendments be rescinded and former wording be reinstituted pending further consultation with the profession.

After that January 30, 2015 Benchers' meeting, Ethics Committee Of The Law Society Of British Columbia requested the Committee to make submissions relating to amendments to the Appendix C in the BC Code regarding which lenders a lawyer can act for in a simple conveyance.

[2] See Tab 4 at https://www.lawsociety.bc.ca/docs/about/agendas/2015-01-30-agenda.pdf and https://www.lawsociety.bc.ca/docs/about/agendas/2015-03-06-agenda.pdf

BC CODE APPENDIX C – REAL PROPERTY TRANSACTIONS

Section 2(b) of Appendix C of the BC Code provides that a lawyer must not act for more than one party with different interests in a real property transaction unless the transaction is a simple conveyance.

Section 3 of Appendix C of the BC Code requires that, when a lawyer acts jointly for more than one client in a real property transaction, the lawyer must comply with the obligations set out in rule 3.4-5 to 3.4-9 regarding joint retainers.

Section 4 of Appendix C of the BC Code sets out factors a lawyer should consider to determine if a conveyance is a simple conveyance:

(a) the value of the property or the amount of money involved,

(b) the existence of non-financial charges, and

(c) the existence of liens, holdbacks for uncompleted construction and vendor's obligations to complete construction.

The Commentary to section 4 of Appendix C of the BC Code lists examples of what types of transactions are simple conveyances and what transactions are not simple conveyances.

Post-rescission of the December 2014 amendments, commentary 1 to section 4 says these transactions are simple transactions:

(a) the payment of all cash for clear title,

(b) the discharge of one or more encumbrances and payment of the balance, if any, in cash,

(c) the assumption of one or more existing mortgages or agreements for sale and the payment of the balance, if any, in cash,

(d) a mortgage that does not contain any commercial element, given by a mortgagor to an institutional lender to be registered against the mortgagor's residence, including a mortgage that is

(i) a revolving mortgage that can be advanced and re-advanced,

(ii) to be advanced in stages, or

(iii) given to secure a line of credit,

(e) transfer of a leasehold interest if there are no changes to the terms of the lease,

(f) the sale by a developer of a completed residential building lot at any time after the statutory time period for filing claims of builders' liens has expired, or

(g) any combination of the foregoing.

Post-rescission of the December 2014 amendments, commentary 2 to section 4 says these transactions must not be treated as simple transactions:

(h) a transaction in which there is any commercial element, such as:

(i) a conveyance included in a sale and purchase of a business,

(ii) a transaction involving a building containing more than three residential units, or

(iii) a transaction for a commercial purpose involving either a revolving mortgage that can be advanced and re-advanced or a mortgage given to secure a line of credit,

(i) a lease or transfer of a lease, other than as set out in subparagraph (e),

(j) a transaction in which there is a mortgage back from the purchaser to the vendor,

(k) an agreement for sale,

(l) a transaction in which the lawyer's client is a vendor who:

(i) advertises or holds out directly or by inference through representations of sales staff or otherwise as an inducement to purchasers that a registered transfer or other legal services are included in the purchase price of the property,

(ii) is or was the developer of property being sold, unless subparagraph (f) applies,

(m) a conveyance of residential property with substantial improvements under construction at the time the agreement for purchase and sale was signed, unless the lawyer's clients are a purchaser and a mortgagee and construction is completed before funds are advanced under the mortgage, or

(n) the drafting of a contract of purchase and sale.

SIMPLE CONVEYANCE - ACTING FOR MULTIPLE PARTIES

The BC Code restricts a lawyer from acting or continuing to act for a client where there is a conflict of interest except as permitted by the BC Code.[3] This applies to real property transactions; a lawyer can only act for "more than one party with different interests only in circumstances permitted by Appendix C".[4] A simple conveyance falls within the exception set out in Appendix C.

A conflict of interest will arise when there is a substantial risk that a lawyer's duties to their client will be significantly and adversely affected by the lawyer's own interest or their duties to another client.[5] The risk to the duty of loyalty and to client representation must be genuine and serious.

[3] Section 3.4-1
[4] Section 3.4-1, commentary 0.1
[5] Section 3.4-1, commentary 1

Various factors for a lawyer to consider in determining if a conflict of interest exists include:[6]

- the immediacy of the legal interests;
- whether the legal interests are directly adverse;
- whether the issue is substantive or procedural;
- the temporal relationship between the matters;
- the significance of the issue to the immediate and long-term interests of the clients involved; and
- the clients' reasonable expectations in retaining the lawyer for the particular matter/representation.

A simple conveyance in a real estate transaction is considered a simple conveyance as the focus is on matters where there is a common interest and purpose. Simple conveyances do not have inherent issues of unpredictability and indeterminacy which will threaten the interest of clients in a joint representation. Considering the above factors, the risk of a disqualifying conflict of interest is unlikely as representations in a simple conveyance have 1) set timeframes for completion; 2) clients with similar objectives and similar interests; 3) a high degree of transparency between the lender and the borrower; 4) a highly temporal relationship in that the purchase transaction and the mortgage transaction will complete virtually simultaneously; 5) a emphasis on procedural matters; and 5) a mortgagor who reasonably expects that their lawyer will handle the entirety of their simple property purchase including the need to meet the requirements of their mortgagee and requisitioning their mortgage funds.

[6] Section 3.4-1, commentary 7

Appendix C of the BC Code confirms this conclusion by expressly permitting joint representation in these circumstances. It also reflects 1) the current state of the real estate market; the disclosure requirements of institutional lenders; 2) the reasonable belief that a mortgagor will have a basic understanding of the terms, rights and obligations associated with an institutional lender mortgage; 3) the minimal risk of divided loyalties or divided interests between clients given the transparency of the process when dealing with institutional lenders; and 4) a lawyer's obligation to ensure informed consent is obtained from all parties.

It should also be noted that cost of borrowing regulations necessitate federally regulated financial institutions to give mortgagors required information in clear language and non-misleading manner. The Office of the Superintendent of Financial Institutions regulates 403 financial institutions including banks, trust companies, loan companies, cooperative credit associations, cooperative retail associations, life insurance companies, and Canadian property & casualty insurance companies.[7] Monoline lenders tend to follow the same rules as Canadian banks and as has been the experience of real estate practitioners on the Committee, have very stringent requirements which a lawyer must meet before mortgage funds are advanced. In fact, these requirements are typically the same and, in some cases, greater when compared to requirements imposed by banks, trust companies or credit unions.

It is the Committee's position that the amendments to the BC Code approved in December 2014 unnecessarily restrict transactions which fall within the meaning of a simple conveyance. The proposed amendments neither reflect the current mortgage options routinely offered to mortgagors nor the broad type of residential mortgages issued by a new-age of lenders such as insurance companies, monoline lenders, and mortgage investment corporations each of which

[7] http://www.osfi-bsif.gc.ca/Eng/wt-ow/Pages/wwr-er.aspx?sc=2&gc=3&ic=1#WWRLink231

lend money in the ordinary course of business and have proven to be accountable lenders subject to certain levels of regulation. While the new-age of lenders may have a range of mortgage products, from those similar to "banks" and "credit unions" in terms of competitive rates and similar prepayment privileges and the like, there are products offered by some lenders including mortgage investment corporations that are at higher rates (arguably justifiable given that the borrower may be a higher risk and therefore not qualify for financing from a 'typical' lender) and these products, in some cases, may contain more restrictions surrounding prepayment (albeit there are MICs that routinely offer "fully open" prepayment privileges) or may, on default, be more rigid in dealing with enforcement against the borrower/homeowner.

Arguably then, there is a real concern to be addressed if the Ethics Committee looks to "expand" the definition as part of addressing what was considered to be "vague" language in the predecessor definition of "institutional lender" because of the range of "other lenders" offering products. However, as set forth hereafter, there may well be room to address this concern by moving away from a rule based approach to an approach that moves toward what has been termed as "high-level outcomes governing practice and the quality of outcomes for clients"[8]. The Solicitors Regulation Authority (SRA) implemented an outcomes-focused regulation in 2011 to implement this change in focus. In addressing conflicts of interest, the Practice Note issued 3 March 2015 relating to the UK Code looks to situations of "substantial common interest" and defines this as "… a situation where there is clear common purpose in relation to any matter or a particular aspect of it between the clients and a strong consensus on how it is to be achieved and the client conflict is peripheral to this common purpose."

[8] UK Law Society Practice Notice 3 March 2015 – Conflicts of Interest

The UK Practice Note affirms that if one engages the exception and accepts a retainer for both sides (i.e. lender/borrower), the decision is dependent upon a reasonable belief that the clients understand the risks and issues, that it is reasonable to act for both sides and that in so doing, one is able to represent the best interests of each client and that the benefits of one solicitor acting for both sides outweighs the risk. While these factors and more must be considered on each and every occasion where the situation arises, it is also important to bear in mind that the retainer, once accepted, must also be kept under review until the retainer is complete. That obligation arises from the fiduciary duty (and the duties as codified in the BC Code of Conduct) that solicitors are obligated to uphold.

LENDING INSTITUTIONS

The Benchers' December 2014 changes to remove the wording "institutional lender" and replace with "bank, trust company or credit union" has the effect of excluding life insurance companies and the "monoline" institutions lenders such as First National Financial, MCAP, Merix and Street Capital to name a few). A review of basic definitions may be helpful in moving forward with this discussion.

Definitions

A "**bank**" takes a deposit, issues bonds or stocks, invests in securities, and lends out money. Banks are federally incorporated and regulated by the Office of the Superintendent of Financial Institutions ("OSFI") pursuant to the *Bank Act*. The *Bank Act* defines "bank" as one of those institutions specifically listed in Schedule I (domestically owned banks) and II (subsidiaries of foreign banks) of this act.

A “**credit union**” is a provincially regulated and co-operative financial institution that provides services similar that of a bank. In BC, a credit union is incorporated under the *BC Credit Union Incorporation Act* and regulated by the BC Financial Institutions Commission (“FICom”) under both the *BC Credit Union Incorporation Act* and the BC *Financial Institutions Act*.

A “**trust company**” is the only kind of financial institution that may act as a fiduciary, agent or trustee in the administration of monies, trusts and estates. Trust companies have limited lending powers as compared to banks. A “**life insurance company**” offers life insurance; relevant to this discussion is life insurance offered for mortgages as compared to mortgage insurance offered directly by banks, trust companies, or credit companies.

Trust companies and life insurance companies can both be incorporated and regulated at either the federal or the provincial level. At the federal level, a trust or life insurance company is incorporated and regulated by the OSFI pursuant to the *Trust and Loan Companies Act* or the *Insurance Companies Act*, respectively. In BC, a trust or life insurance company is incorporated under the *BC Corporations Act* and regulated by the FICom pursuant to both the *BC Corporations Act* and the BC *Financial Institutions Act*.

A “**monoline lender**” is a mortgage lender that only provides mortgages and no other products or services. Monoline lenders may have branch offices for administrative purposes but do not have local branches for other purposes (i.e. deposits etc.) and primarily interact with borrowers through mortgage brokers. Due to reduced overhead cost, these lenders are often able to offer very competitive rates.

Monoline lenders often use a third party facilitator to address the documentation and funding aspects of the loan (First Canadian Title being one). Solicitors encounter some issues from time to time with this model of instruction delivery because there is a perceived inability to deal with the lender directly. However, in general, when a matter of importance arises, it is possible to speak directly to the underwriter. It is the lender who is the client, not the facilitator, and there may be issues yet to address here but they are not of such significance as to warrant precluding solicitors from acting for these types of lenders and their borrowers.

While mortgage brokers are regulated provincially, in BC by the FICom pursuant to the BC *Mortgage Brokers Act*, regulation for monoline lenders themselves is not streamlined. If a monoline lender is a federally company incorporated under the *Trust and Loan Companies Act*, it is regulated by the OSFI. However, if it is a provincially incorporated company (under the *BC Corporations Act*), or a financial entity that is not incorporated, it does not fall under the mandate of the FICom as it does not fall into the definition of "financial institutions" in the *Financial Institutions Act*.

So what then are the concerns in relation to those institutions or entities for whom solicitors arguably wish to continue to act for both parties (lender/borrower) based on the exception arising from the "simple conveyance rule" What differences arise in looking at the variety of lenders there are in the marketplace, that ought to give pause to considering the "simple conveyance" exception to dual representation (lender/borrower). What other factors ought to "weigh in" on the definition of the type of institutions solicitors ought to be able to represent when also representing the borrower. The following, are factors worthy of consideration:

1. Competitive mortgage products. "Monoline lenders" such as Street Capital, MCAP, RMG, and First National Financial are typically engaged by borrowers through mortgage brokers. They appear to offer competitive rates, similar prepayment privileges, prompt turnaround, solicitor instruction websites and are in general singularly in the mortgage lending business, largely residential, with a few exceptions (i.e. MCAP for one has a commercial division).

2. Role of mortgage brokers. Most of the monoline lenders and life insurance company lenders are engaged by borrowers through mortgage brokers. Mortgage brokers are regulated provincially and, arguably, with the upswing in the number of brokers and percentage of borrowers using brokers (as opposed to dealing directly with a lending institution (be it bank, credit union or other), the Provincial Government and Mortgage Brokers association has been addressing further regulation. In BC, that has encompassed the requirement to disclose conflicts of interest.[9] The BC association identifies the competing interest and the potential that exists to influence a decision as to a lender (i.e. remuneration etc. albeit there is no requirement for a broker to disclose the precise amount of remuneration earned from a lender) and focuses in its bulletins on the duties of the broker to the borrowing client. It is worthy to note that in Ontario, provincial regulation concerning mortgage brokers has gone further in that the rules require brokers to disclose if one lender has issued loans that are greater than 50% of the overall loans of that broker and requires all "incentives" to be disclosed.

On the FAQ section of the Ontario website,[10] there are some interesting question/response discussions (i.e., the fact that a broker makes a higher commission on a 5 year term than a shorter term, volume rebates to brokers, incentives) all of which give rise to considerable

[9] MB11-007 Dec 2014 update of September 2011 Information Bulletin, Registrar of Mortgage Brokers
[10] fsco.gov.on.ca/en/mortgage – FAQ on Disclosure of Potential Conflicts of Interest

concern about conflict of interest, before in fact a transaction even reaches the solicitor stage (preparing and registering the mortgage). These conflicts must be addressed by the governing bodies for brokers and through provincial legislation. The conflicts that solicitors must address are similar only in terms of the "best interests of the client" and not, one might say, by reason of remuneration since solicitors tend to be compensated the least in the transactional costs leading up to finalizing a mortgage (i.e. appraisal costs, broker remuneration etc.).

3. Notary Rules in relation to conflicts and simple conveyances. Rule 11.04(b)(ii) of the BC Notary Rules identifies a "simple conveyance" as a transaction "… coupled with a mortgage for an institutional lender such as bank, trust company, life insurance company or credit union." By its wording, the definition is clearly not exhaustive and so, in our view, the door is open to including monoline lenders. Do we wish to put solicitors on a different playing field from notaries? While mortgage work is likely the significant portion of many notaries' services and in direct competition to solicitors, it is unlikely that solicitors ought to be curtailed by a new definition in our Code that puts them at a disadvantage in relation to services solicitors can offer. While there may be other aspects of the notary/solicitor situation to argue, it is not for this commentary. Suffice to say however that a comparison to the definition in the Notary Rules is important to consider in making any changes to the definition in our BC Code.

4. Mortgage Investment Corporations (MIC's) and other lenders. This aspect of the definition of lenders for the simple conveyance exception warrants further consideration. It may be the primary area of concern for the Ethics Committee in that the Committee is seeking to clarify situations where a borrowing client's differing interests, differing bargaining powers or vulnerabilities due to financial situation are worthy of protection in relation to this type of lender.

However, that said, there are MIC's that offer rates that are not significantly out of proportion to the "regular marketplace" and have open prepaying with no penalties.

It is not only the front end of the transaction that must be assessed; it is also the 'back end." In a default situation, a private lender or for lack of a better phrase, a 'non-routine' lender may employ strict enforcement measures and there may be impacts upon the borrowing client that might not otherwise have been the case. These lenders serve an area of the marketplace but heed must be paid to the vulnerability of the borrowers who engage with these lenders. Unfortunately, separate representation results in increased financial burden to the borrower but if the balance of power is disproportionate, that is a the downside to the more paramount concern that we ensure proper independent legal advice is provided so that the client is fully aware of his/her situation before finalizing the transaction. Again, however, it appears that similar to monoline lenders, though to a lesser degree, more and more MIC type lenders are appearing in the marketplace. Not all have excessive rates, not all have unreasonable enforcement policies or excessive broker fees. There is some sort of balance to be struck in addressing when a solicitor might act for both or separate representation is required. This discussion may need to be addressed again as we see if this type of lender growth continues.

The comment regarding private lending is brief. We agree with the Ethics Committee that those parties involved in private lending need separate representation.

RECOMMENDATIONS

The Committee recommends that the use of the explicit identification of "banks, credit unions and trust companies" as the types of institutional lenders that can form part of a simple conveyance is too narrow and, given the content of the Ethics Committee's comments, unduly

and unnecessarily restricts what comprises a simple conveyance. For example, broader wording permitting joint representation of an institutional lender which permits mortgages "given by a mortgagor to an institutional lender such as bank, trust company, life insurance company or credit union" would be appropriate. Further, if deemed necessary, exclusion wording could also be added such as "but excluding mortgages given by mortgage brokers".

Further, if deemed necessary despite the current Code of Conduct requirements for a joint retainer, a commentary similar to the UK Code reminding solicitors to consider whether a substantial common interest exists between the lender and the borrower and whether a strong consensus on how the common interest is to be achieved is present.

CONCLUSION

We would be pleased to discuss our submissions further with the Ethics Committee, either in person or in writing, in order to provide any clarification or additional information arising out of our submissions.

Communications in this regard can be directed to:

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