

- Vulnerabilities in mortgage lending (FICOM, CMHC)
 - Gaps in mortgage lending or in the builder lien regulation used to launder money (such as: 1) criminal actors paying lenders back with proceeds of crime or 2) criminal actors using unregulated mortgage entities to lend and recycle proceeds of crime). This would include unregulated lenders from an AML perspective such as MICs, private lenders etc.
- **Registrar of Mortgage Brokers – Regulatory Framework Overview:**
 - ***Mortgage Brokers Act (MBA)* requires persons carrying on a business as a mortgage broker in BC to be registered and establishes a regulatory framework for the conduct of mortgage broker business**
 - **MBA regulates/registers persons:**
 - **Lending money secured by mortgages**
 - **Private lenders**
 - **MICs**
 - **Syndicated mortgages**
 - **Monolines**
 - **Arranging mortgages for others**
 - **Administering mortgages**
 - **Buying and selling mortgages**
 - **MBA explicitly does not apply to the following for acting as a mortgage broker:**
 - **Savings institutions (Banks, Credit Unions)**
 - **Insurance companies**
 - **Lawyers (BC Law Society, Solicitors) if loan is made in course of and part of their business**
 - **Enforcement provisions under the MBA:**
 - **Unregistered brokers**
 - **Registrar’s authority over unregistered mortgage brokers is strictly limited to sanctioning persons for carrying on business as a mortgagee broker when not registered**
 - **No authority over the conduct of unregistered mortgage brokers (e.g. no ability to sanction unregistered brokers for handling false documents / fraudulent mortgage applications)**
 - **Cease and desist orders**
 - **Maximum administrative penalties up to \$50K**
 - **Provincial offence**
 - **Max \$100K first offence; \$200K second**
 - **Up to 2 years in prison**
 - **Subject to discretion of the courts**
 - **Registered brokers**
 - **Administrative penalties up to \$50K**

- Cease and desist orders
 - Suspension or cancelation of registration
 - Conditions on registration (e.g. supervision)
 - Breach for most misconduct, including anything resembling fraud is “Conduct prejudicial to the public interest”
 - Limited offence remedies under MBA e.g. disclosures, false advertising, unregistered brokering)
 - Registrar of Mortgage Brokers has regulatory enforcement authority under the MBA to enforce certain provisions of the Business Practices Consumer Protection Act for mortgage brokers – only applies to consumer transactions:
 - Cost of credit disclosures
 - Deceptive acts or practices
 - Charging “advance fees” to arrange a consumer mortgage is prohibited (any fees must be deducted from loan proceeds)
- **False documentation used to obtain mortgage:**
- CRA documents – T1 General and NOAs are by far the single most common falsified income documents observed in mortgage broker investigations to support income (often business income); false job letters much less common but still occasionally happen; CRA documents hard to validate, but lenders can more easily conduct due diligence to verify job letters and thus easier to detect when fake
 - Falsified online or paper bank account statements showing financial assets / down-payment information
 - Majority of falsification of income and down-payment information and supporting documents is done post-borrower in the application process:
 - Either the registered broker or an unregistered broker or other 3rd party false document manufacturer within the network of brokers and real estate agents
 - Requires technical knowledge of lending qualification processes, systems and lending policies
 - Borrower often unaware – just happy to get a mortgage; or in some cases (real estate agents involved in flipping etc. are more aware of it, involved in networks linked to brokers who can get mortgages they otherwise would be unable to obtain)
 - Easy to create and alter documents with digital technology – obtain originals, OCR imaging, change numbers, PDF
 - False real estate documents – falsified Assignment of Purchase and Sale to inflate price to effectively get 100% financing; possible to

falsify MLS listings etc.; exploit auto-appraisal systems (e.g. CMHC's Emili); falsified appraisals, harder to detect in escalating market

➤ **Origination Networks of Fraud:**

- Registered or unregistered mortgage brokers – manufacture falsified applications and documents to support inflated income, down-payment assets (hide source of funds)
- Perpetrators typically have industry knowledge and experience in how mortgages are qualified and approved to manipulate the lending system
- Unregistered fraudsters use registered mortgage brokers or employees of financial institutions to “front” the fraudulent mortgage applications on their behalf, keeping the fraudster in the shadows
- Brokers involved in the fraud may have a network of real estate agents directing borrowers to them; access an appraiser willing to manipulate appraisals to inflate property valuation

➤ **Gaps/Vulnerabilities**

- FICOM currently not equipped to undertake offence prosecutions under the MBA (need to develop capacity and legal infrastructure)
- MBA gaps:
 - No prudential supervision of mortgage brokers and non-savings institution lenders, including MICs and private lenders – strictly registrations, disclosure and market conduct (*The policy reason is that solvency of these lenders is not regulated since they raise capital from the securities markets which is regulated through securities legislation and not through deposits or insurance premiums. As well, when acting for borrowers, brokers do not handle lender funds. When acting as a mortgage administrator mortgage brokers must hold mortgage payments in trust funds for lenders and their financial institution are subject to AML/ATF requirements.*)
 - Maximum administrative penalty is only \$50K (global maximum, not a per count basis); observed profit from misconduct in \$100s of thousands and over \$1 million
 - No disgorgement provisions in MBA
 - No offence under the MBA for “Conduct prejudicial to the public interest”; offences restricted to unregistered activity, failure to provide certain disclosures, false advertising
 - No explicit “know your client” or other due diligence requirements on brokers or lenders, although a failure to conduct reasonable due diligence in certain circumstances is inferred through “conduct prejudicial to the public interest”

- **No statutory “Managing Broker” role or explicit obligations on brokerages other than keeping proper records of their business or through the Registrar’s authority to take regulatory action against brokerages whose practices and policies are “prejudicial to the public interest”**
- **No positive obligation on registrants to report suspicious activity to the regulator**
- **No explicit beneficial ownership disclosure required for brokerage registrations – focus is on suitability of officers and directors of registered entity**
- **Risk of straw officers and directors for brokerages – Registrar does not approve suitability of directors, however can consider the registration of the brokerage to be objectionable based on unsuitable directors**
- **No enforcement remedies against individual non-registered beneficial owners, unless they are an officer or director, but shareholder conduct / suitability can affect registration of the brokerage itself and ability to conduct mortgage broker business**
- **Administrative penalties often unpaid if subject is not a registrant or gives up registration; more effective when levied on those who value continuation of their registration**
- **Banks uncooperative in investigations:**
 - **Scotia and TD originate mortgages through brokers (approx. 40% of broker business goes to these 2 lenders)**
 - **Banks explicitly exempt from summons powers under MBA**
 - **Typically, will not provide evidence even when subjects / customers provide authorization to release information and records**
 - **Reluctant to provide substantive information about former employees terminated for misconduct, or offered option to resign, when they subsequently seek registration as a mortgage broker, even with their authorization to release their information**
 - **Section 7(6.1) MBA judicially authorized Order to Enter, Remove or Produce may apply to banks, but is costly, requires affidavit with grounds and application for judicial authorization (not yet tested for banks)**
- **Private / subprime lenders:**
 - **Higher risk / higher yield lending**
 - **May turn a blind eye to suspicious / criminal borrowers**

- Equity based lending with reduced due diligence on borrowers or their income (depends on individual lenders)
 - Quote from major private lender/MIC operator: “My only underwriting criteria is if I am OK to own the property”
 - Mortgage payments typically well under the reporting \$10,000 threshold; makes mortgages attractive instruments for laundering – perhaps a more risk-based criteria for reporting?
 - Mortgage proceeds flow through lawyers and notaries
 - MICs and Syndicated Mortgages have bifurcated regulation: Securities Act (BCSC) for capital raising and MBA for lending (Registrar / FICOM) – securities is mainly investor disclosure
 - Limited uptake by police on apparent mortgage broker frauds
 - Gap between municipal and federal mandate
 - Multiple local police jurisdictions
 - Reported lack of police resources
 - Appraisers in BC are not subject to licensing or regulatory oversight
- Other Risks:
 - Incentives - Mixing risk management and sales (Scotia – Underwriters are “Relationship Managers” mix BDM and underwriting roles in a Relationship Manager, variable compensation incentives
 - Mortgage broker and lending is an industry of “yes”. Market participants only rewarded for getting mortgages approved and funded. No reward for saying “no”.
 - Industry informants advise some underwriters receive unreported compensation/gifts from certain large brokers to “look the other way” on suspect deals
- Limitations on 3rd party income **(and down-payment/financial assets)** verification
 - CRA unable / reluctant to authenticate
 - At one time CRA would produce an NOA to lenders seeking to authenticate income with taxpayer consent, however:
 - Time taken to produce NOA to lender delayed approvals and was a significant barrier to lending; often took longer than the time available to remove subject to financing clauses in purchases of real estate
 - Brokers/borrowers selection bias to avoid lenders that did not require the extra authentication from CRA and competitive opportunity for lenders to reduce barriers
 - Prohibition in the Income Tax Act from use of MBA summons or Orders to Produce powers against CRA
 - Velocity of real estate transactions
 - High time pressure in getting mortgages approved to remove subjects

- **Due diligence comes a cost of time, and if one lender does it but others don't, business goes to those that don't based on velocity of approval**
 - **No efficient authentication of income and financial assets mechanisms between lenders and CRA and other FIs (is customer consent enough to overcome privacy requirement?)**
- **FI legal risk of reporting suspicious activity by mortgage brokers etc. to other FIs or oversight bodies**
 - **Pervasive culture of non-reporting by lenders / FIs and other market participants**
 - **Examples:**
 - **FICOM staff witnessed a presentation (webinar May 2017) made by an executive with a business process outsource company (mortgage administration services) to credit unions about sourcing business form brokers and mitigating fraud:**
 - **Key theme was don't report suspicious activity to regulators / law enforcement unless "100% certain" broker responsible for fraud**
 - **Lenders should first conduct own inquiries to be 100% sure its fraud (Note: lenders under constant time pressure to process deals, not professional investigators and lack tools such as compelling evidence, summons and search warrants)**
 - **Lenders in broker space share information with each other through informal channels fraud groups and REDEX / CITADEL**
 - **Promulgated a false but pervasive myth that reporting suspicions about a broker to a regulator/law enforcement risks libel / slander or breach of privacy legislation**
 - **Confidential sources (employees and former employees of lenders) advise lenders are aware and share info on fraud and brokers involved with each other, but don't report and told not to report outside of the industry to regulators or law enforcement**
 - **Confidential sources advise lenders often tolerate or turn a blind eye to fraud by high producing brokers**
 - **Other influential industry actors (associations, corporate) cite the myth that reporting suspicious activity would breach privacy or risk libel / slander**
- **Fraud for shelter**
 - **See above**
- **For profit mortgage fraud (RCMP)**
 - **See above**