FEDERATION OF ONTARIO LAW ASSOCIATIONS
FÉDÉRATION DES ASSOCIATIONS DU BARREAU DE L'ONTARIO

"The Voice of the Practising Lawyer in Ontario"

June 28, 2019

Law Society of Ontario
130 Queen Street West
Toronto, ON M5H 2N6

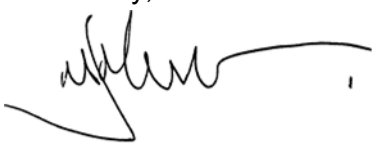
Re: Call for Comment: Proposed Rule Amendment re: Finance Company

The Federation of Ontario Law Associations ("FOLA") is pleased to have the opportunity to provide comments on the Law Society's proposed amendment regarding the definition of "lending client" in Rule 3.4-13 of the Rules of Professional Conduct.

FOLA is an organization representing the associations and members of forty-six local law associations across Ontario. Together with the Toronto Lawyer's Association, our members represent approximately 12,000 lawyers across the province. The vast majority of these lawyers provide front-line services to the Ontario public. Many of our members are real estate practitioners who regularly act for borrowers and lenders and who will be affected by the proposed rule change.

Our response to the call for comment is attached. Please do not hesitate to contact us should have any questions or require any further information.

Yours truly,



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Response to Law Society on Ontario call for comment re: definition of "lending client"

SUMMARY OF CALL FOR COMMENT

The Law Society of Ontario ("Law Society") is proposing to amend the definition of "lending client" in Rule 3.4-13 of the *Rules of Professional Conduct*. Rules 3.4-12 to 3.4-16 generally restrict lawyers from acting for both a both borrower and lender in the same transaction unless a specified exemption applies.

In preparing these submissions FOLA has had a chance to consult with local associations and real estate committees, individual real estate practitioners and organizations/corporations whose primary business is lending money to individuals and businesses.

It is FOLA's position that the current draft definition is far too restrictive and will create situations where individuals and small businesses will be forced by the new Rule to incur delays and additional costs which are unnecessary. By significantly restricting the definition as proposed there are many sophisticated lenders who assist both small business and the general public who will be excluded. The end result will be for the borrowers to incur additional costs with no corresponding benefit. FOLA proposes that certain specified lenders be added to the definition and that consideration be given to designing a broader definition which will include lenders defined by size and lending expertise.

BACKGROUND

The *Rules of Professional Conduct* restrict lawyers from acting for both borrower and lender in the same transaction unless a specific exemption in the Rules applies. The Rule is generally designed to prevent lawyers from acting for both parties if the lender is a private or non-institutional lender. The Rule permits lawyers to act for both lenders and borrowers in a transaction in certain situations, including if the lender is a "lending client".

Rule 3.4-13 currently defines "lending client" as "a client that is a bank, trust company, insurance company, credit union or finance company that lends money in the ordinary course of its business."

The LSO is proposing to amend the definition of "lending client" to read as follows:

a) a bank, trust company, insurance company, or credit union;
b) a finance company that is a corporation or partnership:
    i) whose material business involves making or refinancing loans, or entering into other similar arrangements for advancing funds or credit; and,
    ii) whose shares or ownership interests (or another person or entity with which it is affiliated) are listed on a stock exchange within or outside Canada that is a Designated Stock exchange for the purposes of the *Income Tax Act* (Canada); or
c) a person designed as an approved lender under the N*ational Housing Act* (Canada).

ANALYSIS

The proposed amendment would revise the definition of "finance company" from "finance company that lends money in the ordinary course of its business" to one that is a publicly traded corporation or partnership (or has NHA approval) with a material business in lending money.

The definition of "lending client" is essentially a determination of which lenders are private and which are institutional for the purposes of the special rules relating to dealings with private or non-institutional mortgages.

In most cases, private lenders are less sophisticated than institutional lenders, and do not lend money in the ordinary course of their business. They may not have mortgage commitments or loan agreements and may rely on the lawyer to prepare these. They will not have their own set of Standard Charge Terms and will rely on their lawyer to include appropriate terms either in the mortgage or by way of registered standard charge terms.

Private mortgages generally pose a greater risk for fraud than institutional mortgages. Many private lenders are generally only concerned about the amount of equity available in the property and often conduct minimal due diligence with respect to the borrower. Fraudsters are aware of this, so private lenders become a prime target for fraud.

Additionally, private lenders often lend money to high-risk or vulnerable borrowers who may not qualify for institutional mortgages. Interest rates for private mortgages are generally higher than for institutional mortgages.

Having different rules for private lenders makes sense, both in terms of the increased risk for fraud, and for the protection of vulnerable borrower clients. The issue at hand is how to define which private mortgage transactions require the additional safeguards that having separate representation can provide.

Conflict – Acting for Borrower and Lender

Lawyers are not permitted to act for both a lender and borrower in a mortgage or loan transaction unless:

a) the lender is a lending client;
b) the lender is selling real property to the borrower and the mortgage represents part of the purchase price;
c) the lawyer practises in a remote location where there are no other lawyers that either party could conveniently retain for the mortgage or loan transaction;
c.1) the consideration for the mortgage or loan does not exceed $50,000; or
d) the lender and borrower are not at "arms length" as defined in section 251 of the *Income Tax Act* (Canada).

Essentially, lawyers are not permitted to act for both a private lender and a borrower in the same transaction if the loan amount exceeds $50,000 unless the loan is a vendor take-back mortgage, is between related parties or the lawyer practices in a remote location.

When considering the proposed amendment, it is important to consider the underlying basis for

the rule which, in general terms, is to protect clients who may be unsophisticated or in need of protection. Lawyers are subject to a specific requirement to consider whether the consent of a client (lender or borrower) is appropriate. Rule 3.4-2 provides that "[a] lawyer shall not represent a client in a matter when there is a conflict of interest unless there is consent, which must be fully informed and voluntary after disclosure, from all affected clients and the lawyer reasonably believes that he or she is able to represent each client without having a material adverse effect upon the representation of or loyalty to the other client."

The Commentary to Rule 3.4-16 notes that "Rules 3.4-13 and 3.4-16 are intended to simply the advice and consent process between a lawyer and institutional lender clients. Such clients are generally sophisticated."

Amending the definition of "lending client" to include only those finance companies that are publicly traded or approved under the N*ational Housing Act* (Canada) leaves many sophisticated mortgage investment companies (MICs) as private lenders under the Rules.

Many MICs have portfolios of several million (or billion) dollars and are sophisticated lenders. They do not require the same safeguards that private, unsophisticated lenders do. There are many MIC's that fit within this category. In its consultations, FOLA has been advised of many MICs that would be considered private under the proposed definition, including:

Kingsett Capital - http://www.westboromic.com/

Magenta Capital Corporation - https://magentainvestment.ca/about-us/

Westboro Mortgage Investment Corporation - http://www.westboromic.com/

RiverRock Mortgage Investment Corporation - https://riverrockmic.com/about-us

Atrium Mortgage Investment Corporation - https://atriummic.com/About/Company-Profile.aspx

In addition to the MIC's referenced above, Ontario currently has 61 Community Futures Development Corporations (CFDCs), with 37 in southern Ontario and 24 in the north. These CFDC's offer free business counselling, loans for start-up and expansion of small business, strategic planning on local projects and community economic development in rural areas. CFDCs provide flexible, repayable loans to small and medium sized businesses and are locally managed by a volunteer Board of Directors and funded with federal government support. The CFDC's are sophisticated lenders who should be allowed the flexibility to determine whether independent counsel is required in any given transaction.

The Northern Ontario Heritage Fund Corporation (NOHFC) would also not be considered a lending client under the proposed definition. The NOHFC is an operational service agency established under the Northern Ontario Heritage Fund Act. The NOHFC has an appointed Board of Directors, chaired by the Ministry of Energy, Northern Development and Mines and provides economic development funding toward approved projects in the territorial districts of Northern Ontario, namely Algoma, Cochrane, Kenora, Manitoulin, Nipissing, Parry Sound, Rainy River, Sudbury, Thunder Bay and Timiskaming.

It is important to recognize in crafting an appropriate definition that any new definition will result in an absolute requirement for independent representation of both parties. Under the current

definition, the parties maintain the ability to determine for themselves that independent representation is appropriate in any particular transaction.

Undertakings to Discharge

Lawyers are not permitted to give or accept undertakings to discharge a private mortgage following closing; a discharge of a private mortgage is required for closing. This requirement is reflected in the Law Society Practice Guidelines for Electronic Registration of Title Documents[1] ("E-Reg Practice Guidelines").

E-Reg Practice Guideline 5 includes the following:

> In the case of "private mortgages" (mortgages held by person other than financial institutions), and in the absence of any express provision to the contrary in the Agreement of Purchase and Sale, lawyers should not give or accept personal undertakings respecting discharge after closing. Unless the private mortgage is paid out and discharged prior to closing, it may be necessary for the vendor's solicitor or the mortgagee's solicitor to seek written authority from the lender in the recommended form of Acknowledgment and Direction to create the required electronic form of discharge and arrange for it to be registered on closing.
>
> Acting on proper written authority, the vendor's solicitor could include a Discharge of Mortgage in the DRA as one of the documents to be registered on closing, subject to compliance with the escrow terms of the agreement. The vendor's solicitor would confirm to the lender that a DRA was being utilized as part of the closing procedure and that the discharge of mortgage would be shown as a document for registration under that agreement, subject to the terms of the escrow.

E-Reg Practice Guideline 5 does not include a definition of private mortgage, other than being a mortgage held by a person other than a financial institution. The phrase "financial institution" has historically been interpreted as banks and credit unions as well as trust companies, insurance companies and trust and loan companies licensed by the Financial Services Commission of Ontario (FSCO).

Forms 9D and 9E

The Law Society has specific recording and reporting requirements for lawyers who act for private lenders. By-Law 9 requires lawyers acting for all lenders to:

- obtain a signed investment authority signed by the lender before the first mortgage advance (Form 9D);
- provide a specific form of report to the lender following closing (Form 9E);
- if the mortgage is not held in the name of all of the lenders, obtain an original declaration of trust;
- retain a copy of the registered mortgage; and

[1] Practice Guidelines for Electronic Registration of Title Documents – as approved by Convocation June 28, 2002 https://www.lsuc.on.ca/For-Lawyers/Manage-Your-Practice/Practice-Area/Real-Estate-Law/Mortgages/Electronic-Registration-of-Title-Documents/

- keep any supporting documents provided by the lender.[2]

Forms 9D and 9E are not required if:

a) the lender,

   i) is a bank listed in Schedule I or II to the *Bank Act* (Canada), a licensed insurer, a registered loan or trust corporation, a subsidiary of any of them, a pension fund, or any other entity that lends money in the ordinary course of its business,
   ii) has entered a loan agreement with the borrower and has signed a written commitment setting out the terms of the prospective charge, and
   iii) has given the lawyer a copy of the written commitment before the advance of money to or on behalf of the borrower;

b) the lender and borrower are not arm's length;

c) the borrower is an employee of the lender or of a corporate entity related to the lender;

d) the lender has executed the Investor/Lender Disclosure Statement for Brokered Transactions, approved by the Superintendent under subsection 54(1) of the Mortgage Brokerages, Lenders and Administrators Act, 2006, and has given the lawyer written instructions, relating to the particular transaction, to accept the executed disclosure statement as proof of the loan agreement;

e) the total amount advanced by the lender does not exceed $6,000;

f) the lender is selling real property to the borrower and the charge represents part of the purchase price.[3]

Generally, then, Forms 9D and 9E are required for private mortgages, unless the lender and borrower are not arm's length, the mortgage amount is $6,000 or below, or the mortgage is a VTB.

The exceptions in Bylaw 9 with respect to recording and reporting requirements for private lenders includes banks, trust companies, insurance companies and *any other entity that lends money in the ordinary course of its business* (emphasis added), which is similar to the current definition of "finance company" in Rule 3.4-13.

RECOMMENDATION

As noted above, the proposed amendment is attempting to draw a clear line between sophisticated and unsophisticated lenders, to ensure that clients involved in mortgage transactions with unsophisticated lenders have separate representation.

Rule 3.4-13, the E-Reg Practice Guideline 5 and By-Law 9 all have specific requirements for lawyers acting for a private lender. The definition of private lender (or conversely of institutional

[2] Law Society of Ontario, By-Law 9, s.24(1)
[3] Law Society of Ontario, By-Law 9, s.24(2)

lender) is slightly different in each document as well, but generally accord with one another. Any amendment to the definition of "lending client" or "finance company" in the Rules of Professional Conduct should remain consistent with the E-Reg Practice Guidelines and By-Law 9.

Alternate definition of "finance company":

a) a bank, trust company, insurance company, or credit union;
b) a finance company that is a corporation or partnership:
   ~~i)~~ whose material business involves making or refinancing loans, or entering into other similar arrangements for advancing funds or credit; ~~and,~~
   ii) ~~whose shares or ownership interests (or another person or entity with which it is affiliated) are listed on a stock exchange within or outside Canada that is a Designated Stock exchange for the purposes of the *Income Tax Act* (Canada);~~
c) a person designed as an approved lender under the N*ational Housing Act* (Canada), or
d) a Community Futures Development Corporation that provides financing pursuant to a Community Futures Program administered by the Government of Canada.

Deleting subparagraph ii) from b) would define finance company as a corporation or partnership whose material business involves making or refinancing loans or entering into other similar arrangements for advancing funds or credit. This expands the current definition by requiring financing to be the material business of the corporation or partnership and satisfies the intended goal of requiring different lawyers for unsophisticated private lenders.

The Law Society's proposed definition implies that only those finance companies that are publicly traded are sophisticated. We have heard from many lawyers who disagree.

If there needs to be some threshold to evidence sophistication of a finance company, perhaps it can be a certain level of investment (ie. a company that manages mortgage assets of a designated amount), employs a certain number of people or has a certain number of years experience in the business. This information is not always available on the lender's website, but if it becomes a requirement, they could perhaps be encouraged to confirm in their instructions that they meet the necessary threshold.

The ultimate wording of the definition of lender client will impact lawyers, lenders, and most importantly, the public in Ontario. Comments with respect to this topic are required to submitted by June 30, 2019. While FOLA acknowledges that there has been a reasonable time provided for comment on this topic, we have heard from many real estate lawyers who expressed disappointment in this deadline. June 30 is traditionally the busiest day of the year in real estate, so the weeks leading up to the end of June are often the busiest of the year for real estate lawyers. Additionally, June 30, 2019 is in the middle of the first long weekend of the summer. By selecting this deadline, many feel that the Law Society either does not understand or has no regard for the nature of a real estate practice. Nevertheless, FOLA has attempted to canvas solicitors and lending clients with a view to providing constructive input. We hope that the above comment and suggestions will assist in re-drafting the relevant definition.