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Canadian Centre for Elder Law

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EXECUTIVE SUMMARY

Predatory lending is the practice whereby a lender deceptively persuades a borrower to agree to abusive loan terms. It is closely tied to the concept of subprime mortgage lending, which is the practice of making loans to borrowers who do not qualify for the best market interest rates (people with poor or non-existent credit history or low income). A lender may be expected to require less favourable loan terms in exchange for dealing with a comparatively more risky borrower. But, if the surrounding circumstances include a vulnerable borrower easily taken advantage of due to their own desperate financial circumstances, the situation may be characterized as predatory. Although anyone could be a victim of predatory lending, older adults often fit the profile of having a scant (or even non-existent) credit history, low income, and financial need, all of which predatory lenders tend to seek out.

Predatory lending is a well-known phenomenon in the United States but it is much less known in Canada. This study paper explores the reasons for its low profile, namely the underlying assumptions that the structure established by both the Canadian mortgage market and Canadian legislation are such that there is little cause for concern. The study paper's focus is primarily on how predatory lending may affect older homeowners, but similar issues may arise in connection with individuals who are purchasing a home and obtaining a new mortgage.

Although this study paper does touch upon options for reform from American jurisdictions, it does not provide in-depth evaluation or make recommendations for reform. Rather, the aim of the study paper is to provide a point of departure for further discussion, analysis, and investigation.

This study paper contains six parts. Following a brief introduction in part one, part two provides an analysis of the subprime mortgage market in opposition to the prime mortgage market. The myriad of definitions, legal and otherwise, of predatory lending is then examined. The issue is complicated by the fact that subprime loans provide a useful service in the market. Finally, this part deals with the relationship of predatory lending to elder law.

Part three is a discussion of how various aspects of the Canadian mortgage market can affect the suppression of or the development of predatory lending. The primary factor facilitating this type of lending is the financial situation in which many older adults find themselves. Specifically, older adults are often in possession of considerable home equity yet their actual income is very low. Analysis reveals that the primary factor working to combat predatory lending is cautiousness on the part of typical Canadian borrowers and lend-

ers. Interestingly, such a conservative approach is a result of social and cultural influences rather than any specific laws or financial constraints.

Part four examines existing statutory provisions, at both the federal and the provincial levels, which may provide aggrieved borrowers with remedies. Almost all Canadian regulatory legislation is aimed at traditional financial institutions such as banks, trust companies, and credit unions. By contrast, predatory lending practices are most often carried out by specialized finance companies that are not banks, trust companies, or credit unions.

At the federal level, part four traces the historical development and current relevance of the *Interest Act* as well as the criminal interest rate provision of the *Criminal Code.* Neither of these enactments was intended to address predatory lending and thus their usefulness is extremely limited in this context. Provincial legislation is broken down into four subject areas: cost of credit disclosure, unconscionable or deceptive acts or practices, mortgage broker legislation, and unfair forms of contracts. The focus of the study paper is on the legislation of British Columbia. The provisions of British Columbia's omnibus *Business Practices and Consumer Protection Act* are looked at in detail, particularly those dealing with disclosure of cost of credit and unconscionable or deceptive acts. There is also an analysis of British Columbia's *Mortgage Brokers Act*, including its far-reaching definition of mortgage broker—a definition that may go so far as to encompass the elusive predatory lender.

Part five summarizes options for reform, pointing to some recent alternative models in the United States. These alternatives include legislation in force at both the federal and the state levels and proposals found in academic work. These options are not evaluated in a systematic way, and no recommendations are drawn from them. Instead, they are raised as ideas that may spur the development of the law in Canada.

The conclusion, in part six of the study paper, is that the extent to which predatory lending occurs in Canada is still largely unknown. Research in this area is necessary before the need for law reform can be properly assessed. Although the development of the Canadian subprime mortgage market is a cautious one, this may not hold true for much longer. Senior borrowers may increasingly find themselves victims of predatory lending without legal recourse or remedy.

I. INTRODUCTION

This study paper provides a Canadian perspective on predatory lending. Predatory lending has been the subject of considerable academic debate[1] and some legislative action[2] in the United States. In Canada, in contrast, addressing the topic is challenging because it is seen as non-existent or as affecting very few people. This view came to the fore when news of the crisis in American subprime mortgage lending—which is inextricably linked to predatory lending—began to make worldwide headlines in the summer of 2007. The reaction of the Canadian press was bafflement and indifference. This attitude was summed up by one reporter who remarked, "Until [this August] few Canadians knew what 'subprime' meant. Fewer still could imagine why they should care."[3] The financial press quickly declared that the only segment of the investing public that should care about subprime mortgages were investors in financial institutions. In the United States, increases in subprime lending also brought about increases in several forms of abusive lending practices, which have been collectively labelled predatory lending. The conventional wisdom in Canada is that Canadian homeowners do not and will not for the foreseeable future face a similar threat. This conclusion is found in the popular press[4] and in the one government study of the issue, a brief research project commissioned by the Canadian Mortgage and Housing Corporation in 2004.[5]

This study paper questions this conventional wisdom. It examines the two leading assumptions that support it, which are that the structure of the Canadian mortgage market and the Canadian legal framework for dealing with abusive lending practices are both adequate safeguards against predatory lending. The study paper concludes by touching on the options for reform explored in the United States. It does not evaluate those options or contain any recommendations for Canada, because predatory lending is, at most, an emerging issue here and further study will be needed before arriving at the stage where it will be possible to know if law reform is necessary. The more modest goal of the study

1. *See*, *e.g.*, Debra Pogrund Stark, "Unmasking the Predatory Loan in Sheep's Clothing: A Legislative Proposal" (2005) 21 Harv. Blackletter L.J. 129; Kathleen C. Engel & Patricia A. McCoy, "A Tale of Three Markets: The Law and Economics of Predatory Lending" (2002) 80 Tex. L. Rev. 1255.

2. *See*, *e.g.*, N.C. GEN. STAT. § 24-1.1E (2007) (restrictions and limitations on high-cost home loans). In addition to the United States, the Australian government has shown some interest in considering legislation to curb predatory lending. *See* Laura Cochrane, "Australian states told to regulate risky lending" *The National Post* (20 August 2007) FP5.

3. Barrie McKenna, "The face of the global credit crisis" *The Globe and Mail* (18 August 2007) A1.

4. *See*, *e.g.*, Lori McLeod, "U.S. housing woes get stuck at border" *The Globe and Mail* (17 August 2007) B4 ("Canada has not experienced the same woes because 'we did not push the envelope in terms of exotic mortgages,' Mr. Tal [senior economist, CIBC World Markets] said."); Rob Carrick, "The correct response: Do nothing" *The Globe and Mail* (17 August 2007) A1.

5. *See* Tony Wellman, "Consumer Support and Protection in Mortgage and Home Equity Based Borrowing: The U.S. Experience and Canadian Comparisons" (Socio-economic Series 04-012) (October 2004) [CHMC Report].

paper is to stimulate some interest in the topic, which may lead to more systematic investigations.

II. BACKGROUND

A. Introduction

This section sets out some background information on predatory lending by asking three questions. First, what are subprime mortgages? The study paper attempts to answer this question by pointing out several differences between a subprime mortgage and its natural contrast—a prime mortgage. Second, what is predatory lending? The study paper looks at a number of concrete definitions of this term that have been used in American government and academic publications. And third, why is predatory lending relevant to elder law? The study paper gives some reasons for why older adults have been among the most frequent victims of predatory lending.

B. What are Subprime Mortgages?

The subprime mortgage market differs from the prime mortgage market in a number of ways.

First, the borrowers who make up the subprime market are primarily individuals with blemishes on their credit histories. These blemishes are usually a record of defaults under previous loans, but they may also include the failure to build up a credit history at all. (This tends to occur among younger adults, who have not had an opportunity to borrow funds, and among older adults, who may have been absent from the credit market for an extended period of time.) The subprime market may also include individuals who have no flaws in their credit histories but who earn a modest income. The prime mortgage market, in contrast, is made up largely of individuals with strong credit histories who represent a low risk for lenders.[6]

Second, the identity of lenders differs in the two markets. The prime market is largely made up of banks, trust companies, and credit unions. And, there is heightened competition for borrowers among the banks and credit unions in this market. The subprime market is largely made up of entities that are not banks, trust companies, or credit unions. There is comparatively less competition for borrowers in the subprime market.[7]

6. *See* Engel & McCoy, *supra* note 1 at 1258.

7. *See* Jessica Fogel, "State Consumer Protection Statutes: An Alternative Approach to Solving the Problem of Predatory Mortgage Lending," Comment (2005) 28 Seattle U. L. Rev. 435 at 439 ("Although the prime market remains highly competitive, the subprime market has little competition, virtually no advertisements or other publicity about the price of loans, and limited access to information about the loans." [footnote omitted]).

Third, the purposes of loans in each sector tends to differ. Mortgages in the prime market are usually granted to secure a home purchase loan. Subprime mortgages, on the other hand, less frequently fit the profile of a traditional home purchase mortgage. Subprime mortgages are, more often than not, granted to secure loans made to consolidate consumer debt, loans taken out to respond to short-term emergencies, or loans to refinance existing mortgages.

In Canada, the subprime sector is occasionally referred to as an alternative credit market.[8] This phrase neatly captures the relatively small size of the subprime mortgage market. It is currently estimated to be approximately five percent of the total Canadian mortgage market,[9] but that figure is expected to grow in the immediate future. One report projects the Canadian subprime mortgage market to double over the next five years, in spite of the turmoil in the U.S. market.[10]

Loans made in the subprime market represent a higher risk for lenders. So it is common sense to expect that these loans would carry a higher interest rate and terms that are somewhat less favourable to borrowers. And this trade-off can often be beneficial for subprime borrowers, as it makes them eligible to receive credit that otherwise would not be extended. The expansion of the credit market to include subprime borrowers is generally a positive development—but it is not completely a positive development. The downside of this expansion is that it opens up a greater possibility of individuals falling victim to predatory or abusive loans.

C. What is Predatory Lending?

The challenge in defining predatory lending is figuring out how to draw the line between legitimate subprime loans and illegitimate predatory loans. This has proved to be an elusive task. Many of the definitions encountered in American sources use a very broad

8. *See* Iain Ramsay, "The Alternative Consumer Credit Market and Financial Sector: Regulatory Issues and Approaches" (2001) 35 Can. Bus. L.J. 325.

9. *See* Craig Alexander, "Financial Turmoil Deals an Economic Blow—Not a Knock Out Punch," *TD Quarterly Economic Forecast* (4 October 2007), online: TD Canada Trust <http://www.td.com/economics/qef/qefoct07.pdf> at 4 ("The subprime mortgage market in Canada was only roughly 5% of mortgage originations in 2006, compared to 25% Stateside."). (A chart accompanying the article indicates slow but steady growth in the subprime sector between 2001 and 2006.) *See also* McKenna, *supra* note 3.

10. *See* Lori McLeod, "Alternative mortgage market expected to double" *The Globe and Mail* (20 September 2007), online: globeandmail.com <http://www.theglobeandmail.com/servlet/Page/document/v5/content/subscribe?user_URL=http://www.theglobeandmail.com%2Fservlet%2Fstory%2FRTGAM.20070920.wmortgage0921%2FBNStory%2FrobNews%2F&ord=64187&brand=theglobeandmail&force_login=true> ("Despite the subprime mess in the United States, Canada's alternative mortgage market is expected to more than double in the next five years, according to industry representatives.").

brush to define the term. For example, a leading U.S. government report defined predatory lending in terms of four broad categories of abuses:[11]

(1) loan flipping—which is the practice of repeatedly refinancing a loan over a short period of time, to take advantage of high fees and reduce a homeowner's equity;

(2) excessive fees and "packing"—which primarily involves combining unwanted items—such as insurance or renovation services—with the loan;

(3) lending without regard to a borrower's ability to repay; and

(4) outright fraud.

An article by two American law professors provided a somewhat more detailed definition. They "define[d] predatory lending as a syndrome of abusive loan terms or practices that involve one or more of the following problems":[12]

(1) loans structured to result in seriously disproportionate net harm to borrowers;

(2) harmful rent seeking [this is the practice of using high interest rates or fees to obtain an excessive return on the loan];

(3) loans involving fraud or deceptive practices;

(4) other forms of lack of transparency in loans that are not actionable as fraud; and

(5) loans that require borrowers to waive meaningful legal redress.

These lists give a sense of what is conveyed by the evocative term predatory lending. But it is important to bear in mind that the context surrounding any loan will often determine whether it is legitimate or illegitimate. Some terms and practices can be justified in one context and predatory in another.

11. *See* United States, Department of Housing and Urban Development and Department of Treasury, *Curbing Predatory Home Mortgage Lending: A Joint Report* (Washington, D.C.: Department of Housing and Urban Development & Department of Treasury, 2000) at 21–22.

12. Engel & McCoy, *supra* note 1 at 1260 [footnote omitted].

D. Why is Predatory Lending Relevant to Elder Law?

Older adults are among the most frequent victims of predatory lending. There are a variety of reasons why they are at risk. Many older adults live on a fixed income, which does not allow them the flexibility to overcome unforeseen emergencies. In contrast to their often-limited prospects to earn income, many older adults have built up substantial equity in their homes. This can make them tempting targets for predatory lenders. The present generation of senior citizens has been historically very averse to debt. While this attitude can manifest itself in prudence in financial matters, it can also appear as lack of sophistication due to unfamiliarity with the credit market. Finally, some older adults face social isolation, which can deprive them of the resources needed to evaluate loan products.

III. Factors in the Canadian Mortgage Market that May Encourage or Deter the Development of Predatory Lending

A. Introduction

While American concerns over predatory lending have not escaped notice in the Canadian press,[13] the vast majority of these stories conclude that Canadians are not similarly at risk.[14] The Canada Mortgage and Housing Corporation came to the same conclusion after surveying "43 selected respondents in lending, regulation, credit counselling, brokerage and real estate."[15] Their report's key finding was that ". . . there is no evidence to indicate that predatory lending practices are a problem in Canada."[16] Further, the report found that "[t]here is also little evidence to indicate that such practices will become a problem in Canada in the future."[17]

These conclusions rest on a few factors. This part of the study paper will briefly review them, after discussing the elements in the mortgage market, and society generally, that may encourage predatory lending.

13. *See*, *e.g.*, Kristin Goff, "Foreclosure Nation" *The Ottawa Citizen* (13 October 2007) B1.

14. *See* "Alternative mortgage market expected to double," *supra* note 10; "Foreclosure Nation," *ibid.*

15. CMHC Report, *supra* note 5 at 2. Only ten responses to the survey were received. CMHC Report, *ibid.*

16. CMHC Report, *ibid*.

17. CMHC Report, *ibid.*

B. Factors in the Canadian Mortgage Market that May Encourage the Development of Predatory Lending

The main factors that may encourage the development of predatory lending in Canada relate to the combination of rising home values and declining economic strength.[18] These factors have particular significance for older adults.

There have been sharp increases in the value of real estate over the past decade.[19] For many older adults, these increases have been a welcome development. Older adults have benefited for two reasons. First, many older adults purchased their homes at a time when real estate was comparatively not as highly valued and have remained in those homes.[20] Second, many older adults own their homes outright, having long ago paid off their original mortgages.[21]

This positive development has occurred at almost the same time as senior citizens have begun to see negative developments in other areas of their finances. After a long period in which poverty rates dwindled, older adults in this decade have seen their incomes level off and even begin to decline.[22] Further, a large number of older adults—close to 20 percent—remain disturbingly close to falling below the poverty line.[23] As a consequence, many older adults have their wealth primarily concentrated in their homes.[24]

18. *See* CMHC Report, *ibid.* at 2–3 (also citing "reduced employment security," "internet loan advertising," "profitability of the sub-prime market," and "less powerful lobby/advocacy groups than in the U.S. to ring the alarm bell" as factors that may encourage the rise of predatory lending).

19. *See*, *e.g.*, Canada Mortgage and Housing Corporation, *Canadian Housing Observer 2007* (Ottawa: Canada Mortgage and Housing Corporation, 2007) A-5 (Table 1: Housing Market Indicators, Canada, 1997–2006), A-8 (Table 4: MLS Average Residential Price, Canada, Provinces and Metropolitan Areas, 1997–2006).

20. *See* Raj K. Chawla & Ted Wannell, "Housing Costs of Elderly Families" (2004) 5:7 Perspectives on Labour and Income 13 at 14.

21. *See* Statistics Canada, Pension and Wealth Surveys Section, *The Wealth of Canadians: An Overview of the Results of the Survey of Financial Security* (Ottawa: Minister of Industry, 2006) at 16 (table indicating that 12% of individuals age 65 and over who own their principal residence have a mortgage) *See also Canadian Housing Observer 2007*, *supra* note 19 at 35 ("Nearly 40 per cent of mortgage-free households were maintained by seniors.").

22. *See* National Council on Aging, *Seniors on the Margins: Aging in Poverty in Canada* (Ottawa: Minister of Public Works and Government Services Canada, 2005) at 8 ("Until recently, the percentage of seniors with low incomes had been declining. It went from 21% in 1980, to 10% in 1990, to 7% in 2003. . . . Since the middle of the 1990s, seniors' income has reached a ceiling and the gap between seniors' revenues and those of other Canadians is now increasing." [footnotes omitted]).

23. *See Seniors on the Margins*, *ibid*. at 11 (noting that the income level of 19% of older adults was only marginally above the before-tax low income cut-off).

24. *See* Chawla & Wannell, *supra* note 20 at 17 ("Data suggest that low-income mortgag[or]s could be spending upwards of three-quarters of their income on shelter costs, indicating that many are probably

These conditions mirror the experience of the United States before predatory lending developed into a national problem. There is a sizable pool of older adults who may be susceptible to the need for credit to respond to an emergency. Their home equity could prove a tempting target for predatory lenders.[25]

C. Factors in the Canadian Mortgage Market that May Deter the Development of Predatory Lending

The CMHC Report noted that the "institutional and social framework" of the Canadian mortgage market plays a major role in deterring predatory lending.[26] The factors that emerge from this framework relate to two themes that are cited repeatedly by those who have studied this area. These themes are the caution of Canadian borrowers and the conservatism of Canadian lenders.

Canadian borrowers show their caution both in acquiring mortgage-secured debt and paying down that debt.[27] Largely as a result, there is a lower rate of default on mortgage loans in Canada.[28]

This caution is even more evident in the case of exotic mortgages and financial products geared to older adults. Reverse mortgages, for example, have not received an enthusiastic welcome in Canada. None of the chartered banks have entered the field of offering reverse mortgages. A few credit unions have dabbled in it. For most of the last 20 years, the market has only supported one lender.[29] In 2006, the size of the Canadian market for reverse mortgages was much smaller than the Australian market, despite that country having only two-thirds the population of Canada.[30]

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running down their savings to stay in their homes.").

25. *See* CMHC Report, *supra* note 5 at 2 ("The aging baby boomers of Canada may increase the number of home-equity rich homeowners who are income-poor as [a] result of reaching the end of their employment years. This may create an attractive pool of potential home equity borrowers, some of whom may have difficulty obtaining loans in the traditional market.").

26. CMHC Report, *ibid.*

27. *See Canadian Housing Observer 2007*, *supra* note 19 at 46–47 (reporting findings of survey of mortgage consumers' choices, some of which are headlined "mortgage consumers are cautious about debt"). *See also* Joe Couture, "Don't be panicked into buying a house" *The Regina Leader Post* (27 April 2007) B4 (quoting opinion of economist that "the inherent caution of Canadians will avoid such problems [as predatory lending] in this country").

28. *See* Jim Murphy, "Our Healthy Mortgage Market" *The National Post* (14 April 2007) PH.2 ("The default rate for subprime mortgages in Canada is closer to 2%, significantly less than the U.S. rate.").

29. *See* Jonathan Chevreau, "Use your home's equity, but don't forget the debt" *The National Post* (8 September 2007) (reporting that second reverse mortgage lender has recently entered the Southern Ontario market).

30. *See* Canadian Centre for Elder Law, *Report on Reverse Mortgages* (CCEL Rep. No. 2; BCLI Rep. No.

Canada's banks are closely regulated by the federal government;[31] credit unions and trust companies are also subject to stringent regulation at the provincial level. This regulation fosters a sense of prudence in their dealings with the public. Further, all these institutions are broadly based and have shown little interest in lending in the subprime market.[32] They have also shown little interest in offering unconventional forms of mortgages either to the public generally[33] or to older adults specifically.

D. Summary

These social and commercial factors related to caution appear to provide the main bulwark against predatory lending in Canada. In many respects, social and institutional attitudes have served many people reasonably well.[34] But social attitudes and mainstream institutional arrangements can provide only so much protection. Financial and other circumstances will always drive some individuals to take out high risk loans. The profits that may be obtained from abusive lending practices will always tempt some lenders to cross the line. Anecdotal evidence indicates that there are some victims of predatory lending in Canada, even if we cannot say with certainty how widespread the problem is.

When other forms of protection fail, older adults and others who may have been harmed in the mortgage market will naturally turn to the legal system for a remedy. And it is here that they are likely to be disappointed by a set of laws that have failed to keep pace with changes in the mortgage market specifically and society generally.

IV. Existing Canadian Legal Remedies for Abusive Lending Practices

A. Introduction

Canadian law has two main sources of remedies for those harmed by predatory lending: legislation enacted at the federal level and legislation enacted by the provinces and territories. Neither of these sources contains a statute that is geared to address concerns

41) (Vancouver: The Centre, 2006) at 25; Australian Securities & Investments Commission, *Equity Release Products: An ASIC Report* (ASIC Rep. No. 59).

31. *See Bank Act*, S.C. 1991, c. 46.

32. *But see* Ramsay, *supra* note 8 at 334 ("There is anecdotal evidence of this form of lending by banks." [footnote omitted]).

33. *See* Joanna Smith, "What happened" *The Globe and Mail* (17 August 2007) A8 (citing "avoidance of high-risk mortgage lending" as one reason why crisis in subprime sector should not affect Canada).

34. A recent survey found that "[t]he majority of mortgage consumers (84 per cent) were satisfied with the services they received when negotiating their current mortgage. . ." and that "[m]ore than half of respondents indicated that no improvements were needed in the service they received. . . ." But, "[o]n the other hand, 30 per cent of consumers found the entire experience to be a source of stress, while 26 per cent felt that they had to double-check the advice received and 21 per cent felt they had to fight for the best deal for their needs." *See Canadian Housing Observer 2007*, *supra* note 19 at 46.

about predatory lending. Instead, rules of general application (some of which are very old) must be fitted to a given situation. And these rules of general application can be few and far between.[35] Of particular importance here, it must be recalled that this segment of the mortgage market is home to specialized finance companies that are not banks or other deposit-taking institutions. So, legislation applying specifically to banks or other deposit-taking institutions may not reach the lenders engaged in or the borrowers affected by predatory lending. In addition, very little of the existing legislation recognizes the special problems of older adults who may fall victim to predatory lending.[36]

B. Federal Legislation

The federal government is responsible for legislation relating to interest.[37] It has enacted two laws in this area that may have a bearing on predatory lending.

1. INTEREST ACT

The *Interest Act*[38] is somewhat misnamed. The Act does little to restrain the rate at which interest is charged or paid.[39] Instead, the *Interest Act* is largely focussed on curbing abusive lending terms and practices.[40] Some of its provisions actually address issues that are covered in more recent American legislation dealing with predatory lending. With respect to mortgages, the Act contains a basic cost of credit disclosure rule,[41] prohibits the

35. *See* CMHC Report, *supra* note 5 at 2 (". . . Canada does not have the proliferation of acts and regulatory bodies at the federal and provincial level which exist in the U.S. . . .").

36. A noteworthy exception is Manitoba, the only province with legislation regulating reverse mortgages, a product available only to individuals age 60 and older. *See The Mortgage Act*, R.S.M. 1987, c. M200, C.C.S.M. c. M200, Part III.

37. *Constitution Act, 1867* (U.K.), 30 & 31 Vict., c. 3, s. 91 (19) (reprinted in R.S.C. 1985, App. II, No. 5).

38. R.S.C. 1985, c. I-15.

39. *See* Thomas G.W. Telfer, "Preliminary Background Paper on the Canada Interest Act," in Uniform Law Conference of Canada, *Proceedings of the Eighty-Ninth Annual Meeting* [forthcoming in spring 2008] at para. 5 ("The Interest Act adopts a laissez-faire policy in relation to the rate of interest charged." [footnote omitted]).

40. *See Reliant Capital Ltd. v. Silverdale Development Corp.*, 2006 BCCA 226, 270 D.L.R. (4th) 717 at para. 56, *leave to appeal to the S.C.C. refused*, [2006] S.C.C.A. No. 265 (QL). *See also* Mary Anne Waldron, "The Federal Interest Act: It Sure Is Broke, But Is it Worth Fixin'?" (1997) 29 Can. J. Bus. L. 161 at 164 ("[The Act's] history is the story of Parliament's efforts to protect the borrowing public from what was seen as abusive treatment by lenders.").

41. *Interest Act*, *supra* note 38, s. 6 (requiring certain mortgages to contain "a statement showing the amount of the principal money and the rate of interest chargeable on that money, calculated yearly or half-yearly, not in advance").

application of a penalty, a fine, or an increase in interest payable to late payments,[42] and curbs the extent to which a lender may require penalties for prepayment.[43]

But the *Interest Act* provides little comfort to contemporary victims of predatory lending. The problems with using the *Interest Act* as a check on predatory lending are twofold.

First, the legislation was enacted, in a piecemeal fashion, over the course of twenty years in the late nineteenth century.[44] It has not been amended in any substantive way since that time.[45] The *Interest Act* was primarily aimed at some very specific abusive practices that were occurring in the nineteenth century, but are merely of historical concern today. As a result, the *Interest Act* is a challenge for the contemporary reader to grasp. Some of its language and concepts are nearly impenetrable. It all creates a sense that the legislation is a nineteenth-century relic that is completely irrelevant to modern lending practices.

This sense of the Act's irrelevance leads to the second problem. A stream of court cases has served to limit its scope even further.[46] This development appears to have two causes. First, the terms and practices that the *Interest Act* seeks to regulate are described in fairly narrow terms. Second, the Act applies to a broad range of individuals and businesses. Instead of being a consumer protection statute, it is a statute of general application. Much of the litigation involving the *Interest Act* has been between businesses. Courts are generally reluctant to grant consumer protection remedies to profit-seeking corporations in the absence of very clear statutory direction—and the *Interest Act* does not give clear directions on this point. And this reluctance only increases when the remedies are cast in all-or-nothing terms, as is the case for many of the provisions of the *Interest Act*.[47]

42. *Interest Act*, *ibid.*, s. 8.

43. *Interest Act*, *ibid.*, s. 10 (for mortgages with a term great than five years, at any time after expiration of five years, borrower may tender payment of principal and interest "together with three months further interest in lieu of notice").

44. *See* Telfer, *supra* note 39 at para. 1 ("The essential elements found in today's Interest Act were added piecemeal over a twenty year period between 1880 and 1900 and were never the subject of a comprehensive debate which examined all facets of the legislation at one time." [footnote omitted]).

45. Amendments to the Act, including the addition of regulation-making powers, were contemplated as part of the negotiations over the Agreement on Internal Trade. The amendments were enacted, but they have not been brought into force and no regulations have been promulgated. *See Agreement on Internal Trade Implementation Act*, S.C. 1996, c. 17, ss. 17–18.

46. *See*, *e.g.*, *Kilgoran Hotels v. Samek*, [1968] S.C.R. 3 (section 6); *Ferland v. Sun Life Assurance Co. of Canada*, [1975] 1 S.C.R. 266 (section 6); *Construction St-Hillaire Ltée. v. Immeuble Fournier Inc.*, [1975] 2 S.C.R. 2 (section 8); *Potash v. Royal Trust Co.*, [1986] 2 S.C.R. 351. *See also* Telfer, *supra* note 39 at paras. 15–52 (reviewing the case law in detail).

47. *See Interest Act*, *supra* note 38, s. 6 (providing that "no interest whatever shall be chargeable, payable or recoverable on any part of the principal money advanced" as a result of a breach of the section).

As a result of these two problems, a shrewd predatory lender would have little difficulty in evading the grasp of the *Interest Act*. The Act is something of a dead letter. Over the course of the last twenty years, critics have called for it to be reformed or to be repealed and replaced with something better.[48]

2. CRIMINAL INTEREST RATE

The other federal law governing interest that is worth mentioning here is the usury law. The *Criminal Code*[49] has set the maximum interest rate for this country at the effective annual rate of 60 percent.[50] It is a crime to charge interest that is greater than this rate or to receive a payment of interest that is greater than this rate. The Code defines interest very broadly. It catches payments traditionally not thought of as interest, such as fees and penalties.

This provision was enacted in the early 1980s to deal with criminal loan sharking.[51] Prosecutions of loan sharks under this provision have proved to be rare,[52] but the wide scope of the section has led to it being invoked in large number of civil cases.[53]

The civil litigation involving the criminal interest rate provision has created some confusion over how to apply the section in a non-criminal context. Because much of this litigation has involved relatively sophisticated businesses, the courts have tried to fashion creative remedies to avoid striking down deals negotiated in good faith.[54] The section could be of use in egregious cases of predatory lending, but it would probably be a rare lender that would deliberately structure a mortgage loan carrying an annual rate of interest over 60 percent. As a result, this provision would be of little assistance to most victims of predatory lending. In fact, this section is widely viewed as an embarrassment,

48. *See*, *e.g.*, Waldron, *supra* note 40 at 162 ("Yet the Interest Act lingers on like a moribund patient whose brain has ceased to function but who is kept breathing by artificial lungs attached to constitutional power.").

49. R.S.C. 1985, c. C-46.

50. *Criminal Code*, *ibid.*, s. 347.

51. *See* Jacob S. Ziegel, "Bill C-44: Repeal of the Small Loans Act and Enactment of a New Usury Law," Legislative Comment on S.C. 1980–81–82–83, c. 43, (1981) 59 Can. Bar Rev. 188 at 192.

52. *See* Jennifer Babe, "Section 347 of the Criminal Code: Business Law Problems Remain," in Uniform Law Conference of Canada, *Proceedings of the Eighty-Ninth Annual Meeting* [forthcoming in 2008] at para. 4.

53. *See*, *e.g.*, *Garland v. Consumers' Gas Co.*, [1998] 3 S.C.R. 112; *Nelson v. C.T.C. Mortgage Corp.* (1984), 16 D.L.R. (4th) 139 (B.C.C.A.), *aff'd* [1986] 1 S.C.R. 749.

54. *See*, *e.g.*, *Transport North American Express Inc. v. New Solutions Financial Corp.*, 2004 SCC 7, [2004] 1 S.C.R. 249 (application of notional severance to commercial agreement that breached section 347).

which does little to protect vulnerable borrowers while causing headaches for commercial entities.[55]

3. SUMMARY

The existing federal legislation provides very little protection from predatory lending and more evidence of the stagnation of consumer issues at the federal level. The past 30 years have seen a steady drain of initiative in this area from the federal to the provincial level.[56]

C. Provincial and Territorial Legislation

1. INTRODUCTION

The provinces are responsible for legislation regarding property and civil rights within the province.[57] This power gives them broad scope to enact legislation affecting the economy generally and consumer affairs specifically. Some of this legislation may be of aid to a victim of predatory lending.

There are some variations in provincial legislation across the country. This study paper will focus on British Columbia's legislation in two areas: cost of credit disclosure[58] and unconscionable or deceptive acts or practices.[59] It will also note two other statutes that may be relevant in this context: the *Mortgage Brokers Act*[60] and the *Financial Institutions Act*.[61] This provincial legislation is generally more in tune with the contemporary credit market than the federal legislation, but it by no means represents the most advanced thinking on a range of issues. Instead, moving from federal to provincial legislation is more like moving from the late nineteenth century to the 1970s.

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55. *See*, *e.g.*, Mary Anne Waldron, "Section 347 of the Criminal Code: 'A Deeply Problematic Law,' " in Uniform Law Conference of Canada, *Proceedings of the Eighty-Fourth Annual Meeting* (Ottawa: The Conference, 2003) 250; Jacob S. Ziegel, "Editorial—Section 347 of the Criminal Code" (1994) 23 Can. Bus. L.J. 321 at 321 ("From a commercial point of view the section has been a disaster. There is no evidence that it has done anything to suppress loan sharking, but it has done much mischief to commercial loan transactions that before 1980 would have been regarded as completely legitimate and unobjectionable.").

56. *See* Jacob Ziegel, "Is Canadian Consumer Law Dead?" (1994–95) 24 Can. Bus. L.J. 417. The recent amendments to section 347 of the *Criminal Code*, which exempted provincially regulated payday lenders from its scope, are another illustration of this drift. *See An Act to amend the Criminal Code (criminal interest rate)*, S.C. 2007, c. 9; *Business Practices and Consumer Protection (Payday Loans) Amendment Act, 2007*, S.B.C. 2007, c. 35 (not in force).

57. *Constitution Act, 1867*, *supra* note 37, s. 92 (13).

58. *Business Practices and Consumer Protection Act*, S.B.C. 2004, c. 2, Part 5.

59. *Business Practices and Consumer Protection Act*, *ibid.*, Part 2.

60. R.S.B.C. 1996, c. 313.

61. R.S.B.C. 1996, c. 141.

2. Cost of Credit Disclosure

After a lengthy process, dating back many years, British Columbia's truth-in-lending law came into force in July of last year.[62] The purposes of this legislation are to increase transparency of loan terms and to allow consumers to comparison shop among various loan options. The legislation is complex, covering topics as diverse as advertising[63] and certain aspects of the business of loan brokers.[64] But the core of the legislation, and the way it achieves its purposes is a requirement that lenders give borrowers a standardized disclosure before they enter into a loan.[65]

The disclosure requirements are intended to provide consumers with the total cost of credit,[66] including all non-interest financing charges.[67] This is expressed as a number called the annual percentage rate.[68] The legislation contains detailed requirements governing the content and timing of disclosure. Further, for fixed credit loans, such as mortgages, the disclosure requirements are ongoing.[69]

The legislation contains a number of remedies for breaches of its provisions, including compensation to a borrower who suffers a loss as a result of such a breach.[70] In addition,

62. *See* B.C. Reg. 349/2005. The legislation had been scheduled to be brought into force on 1 January 2006 and 1 January 2005, but its implementation was pushed back two times. *See* B.C. Reg. 349/2005; B.C. Reg. 520/2004. Prior to Part 5, British Columbia had enacted the *Cost of Consumer Credit Disclosure Act*, S.B.C. 2000, c. 13, but it was never brought into force. Both Part 5 and the *Cost of Consumer Credit Disclosure Act* can trace their origins to two law reform projects: the Uniform Law Conference of Canada's *Uniform Cost of Credit Disclosure Act*, online: Uniform Law Conference of Canada <http://www.ulcc.ca/en/us/index.cfm?sec=1&sub=1c3> and the Alberta Law Reform Institute's *Report on Cost of Credit Disclosure* (ALRI Rep. No. 82) (Edmonton: The Institute, 2000). The basic policy ideas underlying truth-in-lending laws go back even further, to the early 1960s. *See* Bruce I. Mccallum, "British Columbia's *Cost of Consumer Credit Disclosure Act*" (2002) 60 Advocate 519 at 520.

63. *Business Practices and Consumer Protection Act*, *supra* note 58, ss. 59–64.

64. *Business Practices and Consumer Protection Act*, *ibid.*, ss. 78–80.

65. *Business Practices and Consumer Protection Act*, *ibid.*, s. 84. *See also* Ramsay, *supra* note 8 at 381 ("Information disclosure has been a central policy in protecting consumers in the credit market. In particular the concept of standardized disclosures of the price of credit in dollars and as a percentage calculation (APR) are central aspects of consumer protection.").

66. *Business Practices and Consumer Protection Act*, *ibid.*, s. 57 (1).

67. *Business Practices and Consumer Protection Act*, *ibid.*, s. 57 (1).

68. *Business Practices and Consumer Protection Act*, *ibid.*, s.57 (1). *See also Disclosure of the Cost of Consumer Credit Regulation*, B.C. Reg. 273/2004.

69. *Business Practices and Consumer Protection Act*, *ibid.*, ss. 85–89.

70. *Business Practices and Consumer Protection Act*, *ibid.*, s. 105.

if a lender receives an overpayment to which is it not entitled in view of the disclosure statements, then this overpayment must be refunded or credited to the borrower.[71] Fines may also imposed by the provincial government.[72]

But the aim of cost of credit disclosure legislation is preventative, rather than remedial. Although it applies to a wide variety of loans, its focus is rather narrow. Although this legislation was certainly a step forward in the areas it was intended to address, it was never meant to be a complete response to predatory lending.

3. Unconscionable or Deceptive Acts or Practices

There is legislation in force in British Columbia that provides remedies in cases involving unconscionable or deceptive acts or practices.[73] This legislation expands and builds on the equitable jurisdiction that the courts have to remedy unfair bargains.[74] It has been in force since the 1970s.[75]

The goals of this legislation are twofold. First, it was intended to overcome the narrow interpretations that the courts had given to their common law remedies.[76] The means used to accomplish this goal primarily relate to directing the court to examine the circumstances surrounding a consumer transaction more broadly than the common law would appear to allow.[77] The legislation also shifts the traditional burden of proof in civil litigation. If a borrower alleges that a lender has committed an unconscionable or a deceptive act or practice, then the burden is on the lender to show that the alleged act or practice was not committed.[78] And, finally, the legislation contains an expanded set of remedies for victimized borrowers.[79]

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71. *Business Practices and Consumer Protection Act*, *ibid.*, s. 104.

72. *Business Practices and Consumer Protection Act*, *ibid.*, ss. 189 (3), 190.

73. *Business Practices and Consumer Protection Act*, *ibid.*, ss. 4–10.

74. The leading cases in British Columbia are *Morrison v. Coast Finance Ltd.* (1965), 55 D.L.R. (2d) 710 (B.C.C.A.) and *Harry v. Kreutziger* (1978), 95 D.L.R. (3d) 231 (B.C.C.A.).

75. *See Consumer Protection Act*, R.S.B.C. 1996, c. 39, Part 5; *Trade Practice Act*, R.S.B.C. 1996, c. 457, ss. 3–5. These two Acts were repealed when the *Business Practices and Consumer Protection Act*, *supra* note 58, came into force in 2004. Their provisions were consolidated into the omnibus *Business Practices and Consumer Protection Act* with few substantive changes.

76. *See* Ramsay, *supra* note 8 at 380.

77. *Business Practices and Consumer Protection Act*, *supra* note 58, s. 8.

78. *Business Practices and Consumer Protection Act*, *ibid.*, ss. 5 (1), 9 (1).

79. *Business Practices and Consumer Protection Act*, *ibid.*, s. 10 (allowing a court to order, among other orders, that a mortgage loan be reopened and to "relieve the consumer from any obligation to pay the total cost of credit at a rate in excess of the prevailing prime rate").

The second goal of this legislation is to promote consumer protection through the establishment of a specialized agency that plays both an educational and an enforcement role.[80]

Unconscionable and deceptive acts and practices legislation appears to be the strongest tool at either the federal or provincial level for combating predatory lending. But it does have its problems. For instance, the courts have not embraced its broad remedial provisions.[81] Further, the goal of creating a strong consumer education and enforcement arm has suffered setbacks. There was a recent acknowledgement of its problems in British Columbia when the government agency charged with consumer protection was reorganized and partially privatized.[82] It is too early to say whether the new Business Practices and Consumer Protection Authority will have the impact that its predecessor lacked.

4. MORTGAGE BROKERS LEGISLATION

Despite its title, British Columbia's *Mortgage Brokers Act*[83] applies to a range of people, extending beyond the commonly held definitions of "mortgage broker." At its most basic, a "mortgage broker" can be defined as an intermediary who arranges mortgage loans on behalf of either borrowers or lenders. A broader, but still commonly held definition, includes someone who acts as the lender and invests one's own money. But the statute goes further, and incorporates those persons who collect money secured by a mortgage as well as those who lend money on the security of ten or more mortgages a year.[84]

A definition of mortgage broker that includes a person who is involved in excess of ten transactions a year is unique to the British Columbia legislation. Mortgage broker legislation in other Canadian jurisdictions does not include such a broad definition. Most provinces do, however, define mortgage brokers to include persons who invest their own

80. *See* Ramsay, *supra* note 8 at 380.

81. *See* Ramsay, *ibid.* at 381 ("The provisions of these [consumer protection] Acts are often not interpreted more generously than common law interpretation or doctrines such as misrepresentation or unconscionability." [footnote omitted]).

82. *See Business Practices and Consumer Protection Authority Act*, S.B.C. 2004, c. 3.

83. *Supra* note 60.

84. *See Mortgage Brokers Act*, *ibid*., s. 1 (defining "mortgage broker" to mean "a person who does any of the following: (a) carries on a business of lending money secured in whole or in part by mortgages, whether the money is the mortgage broker's own or that of another person; (b) holds himself or herself out as, or by an advertisement, notice or sign indicates that he or she is, a mortgage broker; (c) carries on a business of buying and selling mortgages or agreements for sale; (d) in any one year, receives an amount of $1 000 or more in fees or other consideration, excluding legal fees for arranging mortgages for other persons; (e) during any one year, lends money on the security of 10 or more mortgages; (f) carries on a business of collecting money secured by mortgages.").

money.[85] For example, the Newfoundland and Labrador *Mortgage Brokers Act* distinguishes between "mortgage broker" and "mortgage lender"[86] and its registration provisions apply to brokers only.[87]

A significant portion of the British Columbia statute deals with requirements and procedures for registration of brokers. Specified exceptions to the requirement for registration include persons lending money to provide housing to their employees.[88]

There are also provisions allowing complaints to be sworn, which can then be investigated by the registrar. The registrar has extensive powers of inquiry, for example the ability to enforce the attendance of witnesses in the same way a court can. There are notable exceptions as to who can be summoned, such as bank officers or employees. As the result of an inquiry, the registrar may suspend or cancel a broker's registration. The registrar has considerable scope in forming an opinion to suspend or cancel. In addition to breaches of Part 2 or 5 of the *Business Practices and Consumer Protection Act*,[89] harsh, unconscionable, or otherwise inequitable transactions as well as false or misleading statements can form the basis of such an opinion. Mortgage brokers are also prohibited from making false, misleading or deceptive statements in any kind of advertising under section 14 of the *Mortgage Brokers Act*.[90]

The statute allows for appeals to the Financial Services Tribunal. Conflict of interest is also addressed in that a broker who has an interest in a transaction must disclose that fact to both borrowers and lenders.

Although the expansive definition of "mortgage broker" in the British Columbia *Mortgage Brokers Act* has been in force for some time, it is uncertain whether the Act would provide any relief in relation to predatory lending should it emerge as an issue. The fact that anyone who, "during any one year, lends money on the security of 10 or more mortgages" is required to register under the Act would suggest that many different types of lenders could fall under this legislation.

85. S*ee also* Saskatchewan: *Mortgage Brokers Act*, *R.S.S.* 1978, c. M-21; Manitoba: *Mortgage Dealers Act*, C.C.S.M. c. M210; Ontario: *Mortgage Brokers Act*, R.S.O. 1990, c.M.39; Nova Scotia: *Mortgage Brokers and Lenders Registration Act*, R.S.N.S. 1989, c. 291; Newfoundland and Labrador: *Mortgage Brokers Act*, R.S.N.L. 1990, c. M-18.

86. Newfoundland and Labrador *Mortgage Brokers Act*, *ibid.*, s. 2 (d)–(e).

87. Newfoundland and Labrador *Mortgage Brokers Act*, *ibid.*, s. 4.

88. *Mortgage Brokers Act*, *supra* note 60, s. 11 (2) (b).

89. *Supra* note 58.

90. *Supra* note 60.

5. FINANCIAL INSTITUTIONS LEGISLATION

British Columbia's *Financial Institutions Act*[91] provides a regulatory framework governing all provincially regulated financial institutions. The statute defines "financial institution" as a credit union, a trust company, or an insurance company. It also provides for licensing of insurance agents, salespersons, and adjusters under the supervision of the Insurance Council of British Columbia. The statute further provides for a credit union deposit insurance fund. Of interest in the search for provisions that might touch upon predatory lending practices, is section 93 (1), prohibiting the use of unfair forms of contract. The provision reads as follows:

> **Prohibition against unfair forms of contract**
>
> **93** (1) If, in the opinion of the commission, a form of contract in use between a financial institution and its customers or a form of application or advertisement relating to such a contract is unfair, misleading or deceptive, the commission by order may prohibit the use of that form by a financial institution.

It does not appear that this section has ever been used or that similar sections exist in other Canadian jurisdictions. The prohibition against unfair contracts under the *Financial Institutions Act* is of unknown value, especially given its apparent lack of use to date. It must be borne in mind that many predatory lenders are not credit unions, trust companies, or insurance companies and therefore fall outside the scope of this Act.

6. SUMMARY

Provincial statutes such as the *Business Practices and Consumer Protection Act* provide a more promising source of remedies for victims of predatory lending than federal statutes. But they do have some of the shortcomings of their older federal counterparts. This legislation tends not to track changes in the mortgage market after the 1970s. It also does little to address the often especially difficult position of older adults who fall prey to predatory lending.[92]

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91. *Supra* note 61.

92. Another difficulty is beyond the scope of this study paper, but it is worthwhile noting that this legislation is heavily dependent on consumer enforcement through civil litigation. The problems of access to the civil justice system, especially for claims involving amounts less than $100 000, are well known. *See* BC Justice Review Task Force, *Effective and Affordable Civil Justice: Report of the Civil Justice Reform Working Group to the Justice Review Task Force* (November 2006), online: BC Justice Review Task Force <http://www.bcjusticereview.org/working_groups/civil_justice/cjrwg_report_11_06.pdf> at vii (" 'Too expensive, too complex and too slow.' These are the words used by many members of the public and litigants of all types in British Columbia to describe our present civil justice system.").

V. A SUMMARY OF OPTIONS FOR REFORM

A. Introduction

This section notes several options for reform of the law. It begins by describing legislation that has been enacted in the United States, at both the federal and state levels. Then, it touches on proposals that have been championed by academics in a few recent law reform articles.

This section does not evaluate the options for reform or make any definitive recommendations for a path to reform that should be followed in Canada. The goal here is more limited: to raise awareness about proposals that have been tried or debated in the United States. The hope is that this discussion may stimulate ideas that could guide reform in Canada, if a case for reform is made out in the future.

B. Legislation

1. FEDERAL LEGISLATION

The United States does not have legislation specifically tailored to address the rise in predatory lending that occurred concurrently with the expansion of the subprime mortgage sector.[93] But existing federal legislation may remedy some of the issues raised by predatory lending.

The leading federal statute is the *Home Ownership and Equity Protection Act*, which was enacted in 1994.[94] "The purpose of HOEPA," as one commentator described it, "was to set out a system of 'triggers' which activate disclosures and possible restrictions on loans that exceed certain conditions."[95] HOEPA applies to consumer mortgages that have been secured against the borrower's principal residence and that are not "residential mortgage transactions."[96] A "residential mortgage transaction" is defined as a mortgage that secures a loan that is used ". . . to finance the acquisition or initial construction of [the] dwelling."[97]

93. As this study paper was being prepared, the United States Congress was considering a number of bills designed to respond to the rise in predatory lending and the crisis in subprime mortgages. The most noteworthy of these bills is U.S. Bill H.R. 3915, *Mortgage Reform and Anti-Predatory Lending Act of 2007*, 110th Cong., 2007. This bill has passed the House of Representatives and was referred to the Senate Committee on Banking, Housing, and Urban Affairs. *See*, online: Thomas (Library of Congress) <http://thomas.loc.gov/cgi-bin/bdquery/z?d110:HR03915:@@@L&summ2=m&>.

94. 15 U.S.C. §§ 1602 (aa), 1610, 1639–40 (2007).

95. Dan Reynolds, "Predatory Lending in Oregon: Does Oregon Need an Anti-Predatory Lending Law, or Do Current Laws and Remedies Suffice?" Comment (2004) 83 Or. L. Rev. 1081 at 1091.

96. 15 U.S.C. § 1602 (aa).

97. 15 U.S.C. § 1602 (w).

In order to be caught by HOEPA, the mortgage at issue must also set off at least one of two triggers. The first of these triggers relates to the interest payable on the loan. If the annual percentage rate[98] of the loan exceeds ". . . more than 10 percentage points the yield on Treasury securities having comparable periods of maturity . . ." then HOEPA applies.[99] The second trigger relates to non-interest financial charges. If these charges "exceed the greater of 8 percent of the total loan amount or $400" then HOEPA applies.[100]

If HOEPA applies, then the mortgage lender is required to provide the mortgage borrower with an enhanced set of disclosures about the loan.[101] These disclosures partly act as cautions to the borrower[102] and partly provide additional information about the annual percentage rate.[103] Disclosure must be given at least three business days before completion of the loan.[104]

In addition to providing for enhanced disclosure, HOEPA also restricts the use of certain loan terms. For instance, a mortgage to which HOEPA applies must not contain prepayment penalties.[105] If such a mortgage has a term of five years or less, then it must not provide for a final balloon payment.[106] Such a mortgage must not be structured to provide for negative amortization.[107] Finally, HOEPA contains a general prohibition on

98. *See supra* note 68 and accompanying text.

99. 15 U.S.C. § 1602 (aa) (1) (A).

100. 15 U.S.C. § 1602 (aa) (1) (B).

101. 15 U.S.C. § 1639 (a).

102. 15 U.S.C. § 1639 (a) (1).

103. 15 U.S.C. § 1639 (a) (2). HOEPA actually forms part of a larger statute—the *Truth in Lending Act*, 15 U.S.C. §§ 1601–1693r. Disclosure mandated under HOEPA is intended to supplement disclosure required under the *Truth in Lending Act*. The *Truth in Lending Act* is analogous to Part 5 of the *Business Practices and Consumer Protection Act*, *supra* note 58.

104. 15 U.S.C. § 1639 (b) (1).

105. 15 U.S.C. § 1639 (c). There is a rather complex exception to this prohibition. *See* 15 U.S.C. § 1639 (c) (2).

106. U.S.C. § 1639 (e) ("A mortgage referred to in section 1602 (aa) of this title having a term of less than 5 years may not include terms under which the aggregate amount of the regular periodic payments would not fully amortize the outstanding principal balance."). Negative amortization occurs when the amount of a regular periodic payment is not enough to cover the interest that has accrued over that period. If that interest is compounded (as is the case for most mortgages), then the amount of the principal outstanding will rise.

107. 15 U.S.C. § 1639 (f) ("A mortgage referred to in section 1602 (aa) of this title may not include terms under which the outstanding principal balance will increase at any time over the course of the loan because the regular periodic payments do not cover the full amount of interest due.").

lenders repeatedly extending credit without regard to the ability of borrowers to repay their loans.[108]

HOEPA's remedies are court-based. Primarily, HOEPA provides for damages to be paid to borrowers who successfully advance a claim in court.[109] These are actual damages (that is money actually lost by the borrower) or, in certain circumstances, statutory damages.[110]

2. STATE LEGISLATION

Several American states have also moved rather aggressively to counter predatory lending and to remedy the perceived failings of federal legislation.[111] These moves have led to some jurisdictional squabbling between the federal and state governments, but that issue is too involved and complex to cover in detail in this study paper.[112]

Unlike the American federal legislation discussed above, this state legislation was expressly enacted in response to the rise in predatory lending in the subprime sector.[113] Similar to HOEPA, this state legislation applies only if certain thresholds are crossed. These thresholds tend to have a wider scope than the rather more narrowly defined HOEPA triggers.[114] They do aim at the same targets as HOEPA: high interest rates[115] and

108. 15 U.S.C. § 1639 (h) ("A creditor shall not engage in a pattern or practice of extending credit to consumers under mortgages referred to in section 1602 (aa) of this title based on the consumers' collateral without regard to the consumers' repayment ability, including the consumers' current and expected income, current obligations, and employment.").

109. 15 U.S.C. § 1640 (a).

110. 15 U.S.C. § 1640 (a) (2).

111. *See*, *e.g.*, *Florida Fair Lending Act*, FLA. STAT. §§ 494.0078–00797 (2007); N.C. GEN. STAT. § 24-1.1E (2007); N.Y. BANKING LAW § 6-l (McKinney Supp. 2007).

112. *See generally* Christopher R. Childs, "So You've Been Preempted—What Are You Going to Do Now?: Solutions for States Following Federal Preemption of State Predatory Lending Statutes," Comment [2004] B.Y.U. L. Rev. 701. Analogous issues concerning federal–provincial jurisdiction could arise in Canada with respect to any law intended to restrain predatory lending, but their resolution would depend on a distinctly Canadian set of constitutional rules.

113. *See Florida Fair Lending Act*, FLA. STAT. § 494.0078 (2) (b) (". . .While the marketplace appears to operate effectively for conventional mortgages, too many homeowners find themselves victims of overreaching creditors who provide loans with unnecessarily high costs and terms that are unnecessary to secure repayment of the loan. The Legislature finds that as competition and self-regulation have not eliminated the abusive terms from home-secured loans, the consumer protection provisions of this act are necessary to encourage fair lending.").

114. *See* N.C. GEN. STAT. § 24-1.1E (a) (6); N.Y. BANKING LAW § 6-l (1) (g). The *Florida Fair Lending Act*, on the other hand, incorporates the HOEPA triggers. *See* FLA. STAT. § 494.0079 (7).

115. *See*, *e.g.*, N.Y. BANKING LAW § 6-l (1) (g) (i) (statute applicable to first mortgage loans with annual percentage rate exceeding eight percentage points over treasury securities have comparable periods of maturity).

high non-interest charges.[116] But the state thresholds are set to apply at lower interest rates and lower non-interest charges. And, unlike HOEPA, the New York and North Carolina statutes apply to all types of mortgages (except reverse mortgages).

State legislation also has tended to take a more vigorous approach in restraining or restricting the use of specific types of loan terms in qualifying mortgages. For example, the New York statute contains limitations on loan terms that address the following subjects:[117] acceleration at the lender's sole discretion; balloon payments; negative amortization; increases in the interest rate after default; advance payment; fees to modify, renew, extend, or amend the mortgage; mandatory arbitration of disputes; financing of insurance; loan flipping (that is, repeated refinancing of the loan); financing of non-interest charges and fees; bundled home maintenance contracts; encouragement of default; and payments from lenders to mortgage brokers. In addition, the legislation contains a general obligation not to lend without due regard to payment ability[118] and requires a lender to advise a borrower, in writing, to consider obtaining financial counselling before entering into the mortgage.[119]

Finally, state legislation tends to have a broader range of remedies than HOEPA. For example, the *Florida Fair Lending Act* authorizes the state Financial Services Commission to exercise wide ranging supervisory and investigatory jurisdiction.[120] If the Act is breached, one penalty for the lender is forfeiture of the entire amount of interest payable on the mortgage.[121] In a significant point, the provisions of these state statutes could be raised as defences in a foreclosure proceeding by an assignee of the original lender. To grasp the significance of such a provision, it must be borne in mind that many subprime lenders do not carry their mortgage loans for the entire term. Instead, they tend to package them as mortgage backed securities and sell them in a secondary market. These secondary investors were able to rely on general legal rules to shield themselves from claims of unfairness involving the borrower. Since that unfairness involved the original lender, and the secondary investor did not participate in it, the secondary investor

116. *See*, *e.g.*, N.C. GEN. STAT. § 24-1.1E (a) (6) (b) (statute applies if total points and fees payable by borrower exceed five percent of total loan amount if loan is for $20 000 or more or exceed greater of eight percent of total loan amount or $1000 if loan is for less than $20 000).

117. N.Y. BANKING LAW § 6-l (2).

118. N.Y. BANKING LAW § 6-l (2) (k).

119. N.Y. BANKING LAW § 6-l (2) (l). *See also* N.C. GEN. STAT. § 24-1.1E (c) (1) (requiring counselling for borrowers before they enter into qualifying mortgages).

120. FLA. STAT. § 494.00795.

121. FLA. STAT. § 494.00796 (1).

should be able to enforce the mortgage according to its terms, even if its terms breach the statute. This provision removes that argument from secondary investors.[122]

Since this state legislation has only been enacted in this decade, it is much too early to get a definitive ruling on its success or failure. But one study of North Carolina's statute has set out some initial findings of success in suppressing predatory lending without causing undue harm to the broader legitimate credit market.[123]

C. Academic Proposals

1. COUNSELLING REQUIREMENTS

It has been suggested that an effective way to prevent predatory lending would be to equip borrowers with the information necessary to determine whether or not a potential loan is suitable for their needs. To achieve that end Debra Pogrund Stark proposes enacting a "Mortgage Counseling Intervention Law" that would require borrowers to obtain a certificate of counseling from a trained mortgage counselor before securing loans that are potentially predatory.[124] This proposed statute would apply any "high-cost home loan"[125] being considered, which is of a broader scope than current anti-predatory lending laws in the United States. The statute would ensure that borrowers obtain advice from financial experts prior to proceeding through with the loan. Lenders would be legally required to notify borrowers to obtain a counselor and subsequently obtain a "certificate of counseling" prior to closing of the loan.[126] The lender would be obligated to provide counselors with details of the terms of the loan in question and with closing loan documents. The counselor would be employed to determine whether the loan is overpriced, whether the borrower might qualify for a better-priced loan, and possibly how to improve the borrower's credit score and financial situation. The counselor would also ensure that closing loan documents conform to the original agreement.[127] Making these initial determinations would take a relatively short period of time (estimated at approximately 15 minutes[128]) and the cost of such a service could be regulated and limited to a nominal

122. This area was also a major point of contention between the American federal government and state governments over jurisdiction to legislate with respect to predatory lending. *See* Nicholas Bagley, "Subprime Safeguards We Needed" *The Washington Post* (25 January 2008) A19.

123. *See* Keith Ernst, John Farris, & Eric Stein, *North Carolina's Subprime Home Loan Market After Predatory Lending Law Reform: A Report from the Centre for Responsible Lending* (Durham, NC: The Centre, 2002) at 4 (finding that North Carolina legislation "is estimated to have saved borrowers at least $100 million").

124. *See* Pogrund Stark, *ibid.* at 141.

125. *Ibid.* at 140.

126. *Ibid.* at 143.

127. *Ibid.* at 141.

128. *Ibid.* at 137.

amount.[129] A borrower would also be able to obtain advice regarding potentially problematic and confusing terms such as balloon payments, negative amortization and prepayment penalties.[130] Should a loan be determined overpriced and a certificate of counseling not obtained by the lender, the borrower would be able to obtain rescission and restitution damages.[131] Training and payment of counselors would be publicly funded with possible assistance from legal clinics at various law schools or funded in part by licensing fees paid by banks and mortgage lenders.

2. VOLUNTARY SELF-EXCLUSION

Alternatively, Kurt Eggert suggests a solution that focuses specifically on seniors as they are often targeted by predatory lenders.[132] He proposes the advent of a formal document, called an Elder Home Equity Loan Instrument ("Elder HELP Instrument"), which seniors could sign to limit the terms of any loan they might secure with their principal residence. The instrument would enable seniors to exclude themselves from loans with any of a set of potentially confusing or harsh terms.[133] Seniors would be able to cancel the Elder HELP Instrument and obtain a loan with barred terms by receiving certification from a consumer credit counsellor unaffiliated with the lender, certifying that either the loan is appropriate or that the counsellor has discussed the benefits and determents of the loan being considered.[134]

The Elder HELP Instrument would be an addition to existing or proposed measures designed to protect homeowners generally from high cost loans. Unlike current anti-predatory lending laws in the United States, the Elder HELP Instrument could explicitly bar high interest rates above a particular amount calculated with reference to a benchmark of fees in excess of a certain percentage.[135] Lenders would be on notice of the limitations imposed by the Elder HELP Instrument. If a loan violated the instrument, contradictory terms of the loan would be void and replaced by the terms provided by the instrument.[136] Any court of competent jurisdiction would have the power to order rectification of the loan agreement.[137] The instrument could decrease the complexity of suits that arise from

129. *Ibid.* at 142.

130. *Ibid.* at 138.

131. *Ibid.* at 144.

132. Kurt Eggert, "Lashed to the Mast and Crying for Help: How Self-Limitation of Autonomy Can Protect Elders from Predatory Lending" (2003) 36 Loy. L.A. L. Rev. 693 at 704.

133. *Ibid.* at 758.

134. *Ibid.* at 763.

135. *Ibid.* at 761.

136. *Ibid.* at 762.

137. *Ibid.*

predatory lending by eliminating the need to rely on testimony regarding what representations were made in the event of litigation for fraud or misrepresentation.[138] The system proposed is comparable to gambling self-exclusion laws. In some states gamblers can request to be excluded from one or more casinos in the state. Gamblers can have their names put on lists that are circulated to the casinos and the state then mandates punishment that may involve ejection from the casino, seizure of winnings, or incarceration.[139]

3. SUITABILITY

A third proposal for combating predatory lending is drawn from securities law and would involve imposing a "suitability" requirement on mortgage lenders.[140] Unlike the proposals discussed earlier, this scheme puts the onus for restraining predatory terms and practices on lenders and brokers rather than on borrowers. In securities law, the suitability requirement restricts a salesperson to recommending only securities that are suitable to the needs of a customer.[141] A similar requirement for mortgage brokers could be tailored to the subprime mortgage market. Placing an affirmative duty on lenders is appealing because they are also in a better place to stop deceptive lending practices. Lenders design loan terms, specialize in acquiring information relating to loans, and some have been found to be consciously employing marketing strategies designed to elicit consumer trust.[142]

The suitability standard proposed by Professors Engel and McCoy includes a prohibition on the granting of subprime loans to borrowers who cannot repay the loan out of their current income. The standard is based on a reasonable investigation and on facts known at the inception of the loan.[143] Granting subprime loans to borrowers who qualify for prime rates would also be prohibited. Refinancing would require an economic rationale for borrowers.[144] The loan fees and charges would be transparent and conform to legitimate pricing functions. Borrowers would not be able to waive suitability protections, as doing so would open the door for lenders to engage in the very abuses that the law is attempting to protect.[145]

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138. *Ibid.* at 770.

139. *Ibid.* at 748.

140. *See* Engel & McCoy, *supra* note 1 at 1318. For the concept of suitability in the securities sector, *see* Investment Dealers Association of Canada, Regulation 1300.1 (q) ("Each Member, when recommending to a customer the purchase, sale, exchange or holding of any security, shall use due diligence to ensure that the recommendation is suitable for such customer based on factors including the customer's financial situation, investment knowledge, investment objectives and risk tolerance.").

141. Engel & McCoy, *ibid.* at 1338.

142. *Ibid.* at 1335–37.

143. *Ibid.* at 1343.

144. *Ibid.*

145. *Ibid.* at 1346.

The suitability requirement would be enforceable by individuals, by government, and, through mandatory self-regulation, by industry.[146] Self-regulation would be achieved by having mortgage lenders and brokers form and join self-regulatory organizations that adopt suitability rules and rules of fair dealing.[147] A breach of the duty of suitability standards would create a new cause of action and borrowers and government would be able to bring suitability claims forward. The proposal also suggests there be additional oversight by an appointed agency with the mandate to enumerate practices falling under the suitability requirement and to interpret the suitability rules.[148] Violations of suitability would be redressed with a variety of remedies, including rectification of the loan agreement, disgorgement, and damages.

VI. CONCLUSION

These options may or may not be appropriate for Canada, but before they can be effectively evaluated, some basic questions must be answered. Empirical research is needed to answer whether predatory lending is or will be a problem in Canada, what the scope of predatory lending is in this country, and whether legislation is warranted to address it.

The hope is that this paper creates interest in carrying out this research. In addition, it would be helpful if some of the general law reform projects, particularly those examining the federal legislation in this area, would pay heed to the specific issue of predatory lending.

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146. *Ibid.* at 1337.

147. *Ibid.* at 1338.

148. *Ibid.* at 1341.

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