

Errors & Omissions Coverage for Mortgage Brokering
A report by the Mortgage Broker Regulators’ Council of Canada
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Context

The Mortgage Broker Regulators' Council of Canada (MBRCC) is a forum for Canadian mortgage broker regulators to collaborate and promote greater regulatory consistency to serve the public interest. The MBRCC's vision is effective mortgage broker regulation that balances consumer protection within an open and fair marketplace.

In its 2016–2019 Strategic Plan, the MBRCC noted that the context that mortgage brokers operate in continues to evolve and change. A prolonged low interest rate environment, demand-driven housing markets in some areas and the impact of decreased oil and commodity prices in other areas were three of the trends that drove the MBRCC to identify the enhancement of consumer protection as a strategic priority. As part of that priority to promote a common regulatory approach and consistent standards for mortgage brokerages¹, MBRCC included the development of a report providing recommendations for criteria for professional liability insurance, more commonly referred to as Errors and Omissions (E&O) insurance, including coverages and trailer provisions in its strategic initiatives for 2016-2019. This initiative was designed to ensure there are appropriate levels of insurance coverage that provide consumers with a safety net for negligent actions and damages caused by mortgage brokers, as well as appropriate levels of protection for mortgage brokers.

E&O insurance is a type of professional liability insurance that protects companies, their workers, and other professionals against claims of inadequate work or negligent actions. This kind of liability insurance is generally required for professional advice-giving or service-providing businesses. E&O insurance provides coverage for the legal liability of professional services such as those provided by architects, engineers and accountants, as well as mortgage brokers. It often covers both court costs and any settlements up to the amount specified by the insurance contract. Few regulatory requirements protect the public interest as clearly and directly as the E&O requirement. The point of E&O coverage is to ensure that a fund is available to compensate any member of the public who suffers financial loss due to the negligence or fraudulent activity of a licensed mortgage brokerage.

¹ For the purposes of this report, the term “mortgage brokerage” is used generally to include all licence categories across the provinces: submortgage broker, associate, salesperson, agent and broker.

Methods

Following the publication of the 2016-2019 Strategic Plan, the MBRCC created the E&O committee (the committee) tasked with developing recommendations for E&O insurance criteria on behalf of the MBRCC.

In an effort to ensure there are consistent, appropriate coverages for consumers, the committee undertook a review of the existing landscape. This assessment included an analysis of the current regulatory requirements and considerations regarding the appropriate levels of protection for mortgage brokerages and consumers. The committee reviewed E&O policies to consider what should be included, excluded, and the potential impact of private lending or syndicated mortgage business on the affordability or availability of E&O insurance. Appendix A – Comparative Jurisdictional E&O Insurance Requirement Analysis (“Appendix A”) summarizes this analysis and illustrates current requirements across the country. As a result of this first stage analysis, the committee developed a Definition Guide for regulators intended to consolidate common insurance terms related to professional liability insurance.

The committee then conducted consultations with mortgage broker regulators (regulators), insurers and insurance intermediaries (“insurance industry”) and mortgage broker industry representatives (“mortgage broker industry”) across the country². The first phase of the consultation was conducted in 2018 and the second was conducted in 2019. The consultation responses were then consolidated and analyzed to identify current and potential risks and coverage issues related to E&O insurance coverage.

² Generally as a group referred to as the “respondents”

Respondent Comments

The Impact of Industry Trends

When asked what macro and/or mortgage brokering industry trends respondents are seeing or forecasting that could impact the potential for claims involving mortgage brokerages, the apparent rise in private lending was the most common response among all three groups of respondents. Insurers also expressed concerns about the higher risks associated with syndicated mortgages. More broadly, respondents identified higher housing prices, stricter lending guidelines and a changing real estate market as factors that could affect claims and could warrant increased insurance coverage. One mortgage broker industry respondent noted: “The macro prudential changes made by the federal government, alongside the various provincial government’s [sic], have contributed to a significant slowdown in the housing market in many areas of the country, and property valuation erosion.” The respondent goes on to say “Private investors are much more likely to list all parties to any mortgage that experiences a loss joint and severally in a civil suit, which will increase defence costs for insurers even where suits are groundless.”

Respondents were also asked specifically whether they expect such trends to warrant increased coverage for mortgage brokerages and why. The respondents offered distinct perspectives. The mortgage broker industry offered varying responses but there was general agreement that current trends warrant increased E&O insurance minimums limits. Regulators consistently indicated that, while there are concerns that current E&O insurance minimums might be insufficient, thus far there is insufficient evidence to support taking action on this. “The existing E&O does not reflect prevailing market conditions but given the low claim amounts may still be adequate,” noted one regulator. There was general agreement among insurers that recent trends will influence the affordability and/or availability of E&O insurance for mortgage brokerages: “There is already an insurance coverage availability shortage on this class of business and higher limits would add some challenges,” said one insurance industry respondent.

MBRCC Observations: It is important to note that all respondent groups raised similar concerns about the marketplace conditions that could threaten the affordability and availability of E&O insurance. All marketplace participants need to take measured responses that are within their control to manage the risks to affordability and availability. Accordingly, mortgage brokerages need to follow the law and conduct of business standards to keep losses low, regulators need to ensure that rules and regulations do not deter insurers from providing E&O products and the insurance industry needs to support education of clients, better risk management and provide market suitable products.

Current Claims and Premiums

In an effort to gauge the adequacy of current standards, regulators and insurers were asked about the average claim amounts by province. In many cases information was not available and examples that were offered varied widely, with regulators citing average ranges from \$10,000 to \$120,000. Insurers cited average ranges from \$25,000 to \$1,000,000 per claimant (although these often include punitive damages and the resulting claim size to an insurer could often be significantly less). All three respondent groups were asked about the primary loss causes for reported claims and the main responses included: decreased housing affordability, changes in mortgage rules, an increase in the use of alternative lending (e.g. private lenders, mortgage syndications, mortgage investment companies [MICs]), higher costs than originally represented, interest rate or payout penalties not fully disclosed, loss of deposits because of poor advice and mortgage fraud or scams. One mortgage broker industry respondent provided a very detailed response:

There are five general categories of claims:

- A. Private lenders alleging that the mortgage broker/agent did not provide the appropriate and/or accurate underwriting information that they required to fund the mortgage.*
- B. Private lenders alleging that the mortgage broker misrepresented the mortgage opportunity in order to convince the lender to fund the mortgage.*
- C. Institutional lenders or their mortgage insurer allege that the mortgage broker provided inaccurate information (allegations of fraud can be included in these claims).*
- D. Borrowers allege conflict of interest claims against the mortgage broker because the borrower feels that the broker placed them into a higher interest cost mortgage that was not the best option for the borrower. Higher compensation from certain lenders can also [be] referenced in claims against mortgage brokers.*
- E. Borrowers who did not received a mortgage allege that the mortgage broker warranted that the borrower would receive funding. The borrower may have suffered a financial loss as a result of not receiving funding.*

When asked about the average policy premiums (for mortgage brokerages) in their provinces, information was in most cases not available or examples varied widely (regulators cited premiums ranging from \$245 [likely per person] to \$260,000 [likely per brokerage]), although a few responses suggested that the average cost is less than \$5,000. Insurers also noted that premiums vary widely and many respondents reported on the factors that influence premiums, including the size of the firm, the reported revenues, numbers of mortgage licensees, as well as the type of business they conduct. A more concise answer was provided by an insurance industry respondent: "In general, plain vanilla brokerages (100% residential, 100% institutional)

have great affordability of coverage and premiums are almost always under [\$5,000]. However, for brokerages involved with private lender, MICs and mortgage syndication premiums are close to [\$10,000], but can be higher if it is a large firm.”

MBRCC Observations: All respondents appear to have a similar understanding of what contributes to the cost of E&O insurance. It is troubling that between regulators and insurers there is little comprehensive statistical information about premiums and claims on which better decision making can be based. It is important for both these groups to improve the quality of statistical information available for this valuable consumer protection tool.

Other Factors Affecting Minimum Coverage

All respondents agreed that there are many factors that should be considered when setting the regulatory E&O insurance minimums, including: average claim, market trends, alignment between jurisdictions, complexity of products, past performance of the broker and brokerage, the number of licensed professionals covered by the policy, the funding sources, the loan to value ratios and the volume of mortgages funded annually. Responding regulators made other observations like, “Consumer protection is the priority in the establishment of limits. Regulators need to ensure that the limits are suitable to deal with most potential E&O claims.” An insurance industry respondent made a broader observation: “Most financial professionals carry limits between \$1M[illion] and \$5M which are currently available in the Canadian marketplace.” As noted in Appendix A the province of Quebec requires minimum limits of \$1M per claim, \$2M annual aggregate limit, with defence costs in addition.

When asked directly about their recommendations for the minimum amount of insurance coverage for any one claim occurrence, as well as all (aggregate) claim occurrences during a 365-day period involving a mortgage brokerage in order to provide adequate liability protection, there was some support for increasing the limits. Regulators agreed that minimums should not be reduced. There was some support among mortgage broker industry respondents for increasing limits per incident to \$1M per incident and \$2M aggregate; higher limits were mentioned for firms with a large number of brokers and agents. Among insurance industry respondents, general agreement was that \$1M per claim is adequate and none of these respondents recommend increasing minimums above \$1M per claim amount.

MBRCC Observations: Notwithstanding recommendations of higher minimum limits, there was no actual evidence of insufficient coverage based on the information provided under the premiums and claim sections. It appears that, in the absence of better statistical information, the generally required limits of \$500,000 per occurrence and \$1 million annual aggregate are adequate but loss experience should be monitored to ensure that consumer protection is not put at risk as loss severity may rise.

Extended Reporting Period and Prior Acts

An Extended Reporting Period (ERP) is a designated time period after a claims-made policy has expired or cancelled during which a claim may be made and coverage triggered as if the claim had been made during the policy period. There are different regulatory requirements and/or availability as a trailer provision in some Canadian jurisdictions, and this coverage varies in length under different circumstances – see Appendix A.

When asked what the impact of extending the mandatory ERP from current limits that may be as low as 60 days to 36 months would be, regardless of whether the insurance is terminated by the insured or insurer, regulators were generally in favour of this change but mortgage and insurance industry respondents were concerned about negative impacts on affordability and availability.

Responses from the mortgage broker industry varied but there was shared concern that this change would negatively impact the affordability and availability of coverage. There was general agreement among the insurance industry respondents that indicated extending the mandatory ERP to 36 months could be cost prohibitive and could likely reduce the availability of broader policy coverages. “This would increase pricing dramatically (+225%) and some carriers wouldn’t be able to offer ERP terms to difficult risk (mortgage syndication), so would reduce availability of coverage,” said one insurance industry respondent. “Philosophically we are supportive of a mandatory ERP, but think a market assessment of the feasibility and cost implications should be undertaken prior to its implementation,” noted a mortgage broker industry respondent.

Several regulators indicated a mandatory ERP offers enhanced consumer protection in the event a policy lapses for any reason. As one regulator respondent noted: “An incremental approach may be an option to consider for extending the mandatory ERP. Instead of extending the mandatory ERP to 36 months, it may be prudent to extend it to 12 months in the first instance.”

Insurance industry respondents also agreed that where ERP is mandatory, and if it were to become mandatory in jurisdictions where it currently is not, the insurance provisions/coverage during the designated period would be the same as those under the core policy and that the interrelation between prior acts coverage and the ERP needs to be explicitly outlined in the policy. They also indicated there could be duplication/redundancy if the policy does not adequately outline the interrelation between prior acts coverage and the extended reporting period. This is a concern for regulators and the mortgage broker industry.

MBRCC Observations: Clearly, there appears to be a concern about the adequacy of the nominal 60-days ERP if there is an insured initiated cancellation versus the 12-month ERP if the policy is cancelled by the insurer. There is also a concern about the affordability impact if the

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ERP period were required to be extended but it does not appear to be prohibitive if done incrementally. However, there is little in the way of empirical evidence to establish the level of claims reported in the ERP or claims that are denied as being outside the ERP. Additional statistical data would assist regulators and the insurers in better assessing the nature of the coverage required.

Private Lending

Respondents' concerns regarding private lending was summed up by one regulator: "This area of lending is prominent in our province and appears to be a growing trend nationally. Many applicants have experienced difficulties in obtaining E&O coverage if/when a large percentage of their business is in the private lending sphere." So when asked whether, given marketplace changes, E&O insurance providers should be mandated to make coverage for private lending activities available to mortgage brokerages, the mortgage and insurance industry respondents offered opposing responses while regulator responses varied due to legislative differences regarding private lending.

The mortgage broker industry respondents were unanimous in their agreement that providers should be mandated to make options for obtaining coverage for private lending activities available to mortgage brokerages. One mortgage broker industry respondent summarized the position as follows:

We believe that all insurers who have been approved by Provincial Regulators to provide E&O liability should be mandated to include coverage for private lending activities in their policies provided to Mortgage Brokerages. It will become confusing for mortgage brokerages seeking coverage to determine if the E&O policy they have purchased is actually covering their private lending activities.

Insurance industry respondents argued that E&O insurance providers should not be mandated to make options available for mortgage brokerages to obtain coverage for private lending—they should have the option to underwrite this exposure. At least one insurance industry respondent stated that "... [mortgage broker E&O insurance] is a non-target class of E&O we are not actively pursuing this class of business," highlighting mortgage broker industry concerns. Most indicated that a mandatory product would negatively impact availability of coverage and there was agreement that such coverage would likely reduce the affordability of E&O insurance. But there were some insights offered by the insurance industry respondents that could help address the availability in what one respondent called "an already thin field":

"It is also important to clarify what is meant by private lending activities. Is this simply referring to mortgage brokers assisting their clients to obtain mortgages from private lending sources? Or is there an element of investment advice being provided by the mortgage brokerage to the potential private lender. The latter scenario would have a significantly increased impact on affordability and availability."

"... most of the policies do not exclude private lending as such it is therefore covered as it is part of their usual scope of work if declared under the application. Underwriters factor this in when they price the risk."

“The implementation of a robust risk management program would be beneficial. Risk prevention measures and education by the industry regulators in conjunction with the insurers and the implementation of standard protocols and forms could assist in creating a standard process and making insurers more comfortable with the risk.”

“E&O for mortgages broker [sic] who are involved with private lending is always more expensive, but there still are markets capable of offering terms....”

MBRCC Observations: E&O insurance provides an important consumer protection backstop for the mortgage broker industry. Therefore, it is not surprising that all respondents had much to say on the subject and that there was a healthy tension between what the mortgage broker industry desires and what the free market is prepared to offer. Regulators have the difficult role of determining the balance between market forces and consumer protection. Presently, there appears to be some availability in the marketplace; however, it and affordability are being threatened by the actions of some bad actors. Regulators may wish to consider further study on private lending practices.

Dealer versus Individual Model

The discussion around who should be insured, be it the mortgage brokerage (“dealer”) or the individual licensee, has been regularly discussed at mortgage broker industry consultations. The committee included questions related to this discussion because one of the most common reasons for advancing the insurance for the individual versus the dealer was the perceived cost burden transferred onto mortgage brokers by their brokerage due to the poor practices of “other” individuals. An argument for the dealer model was the comprehensive nature of coverage including all individuals related to the dealer and reduced administrative burden for regulators. By asking questions associated with that discussion, we hope to add more empirical evidence to future discussion, as opposed to being a catalyst for regime change.

When asked whether having the mortgage brokerage or “dealer model” serves the mortgage broker industry efficiently and effectively for obtaining and maintaining E&O insurance, respondents from all three segments generally agreed that it has. Several mortgage broker industry respondents indicated that an individual or hybrid dealer/individual model might be considered, as represented by this comment: “The dealer model has served the industry reasonably well but is flawed in that [it] can penalized [sic] a whole brokerage or industry at large based on the acts/claims [of] a few”.

If the implementation of an individual model were to be considered, insurance industry respondents advised that there would still be a need for protection for the brokerage itself. As one insurer noted: “If the E&O insurance is based on an individual model, consideration must be made to the protection of the firm for its own negligence (e.g. negligent training or supervision).” All three respondent groups agreed that this is the case.

Insurance industry respondents also generally agreed that if an individual model were introduced the responsibility for reporting cancellations of E&O insurance and the associated administrative burden should fall on the mortgage broker industry and regulators, rather than on insurers.

MBRCC Observations: In spite of the strong feelings for an individual model by many mortgage broker industry respondents, little in the way of evidence was provided as to how consumer protection might be advanced through such a model, other than another level of coverage. But there was no evidence showing the current inadequacy of liability limits, particularly given the information reviewed in that part of the paper. If the mortgage broker industry is so concerned about bad actors, it is within their control to report these parties to a regulator and/or to develop their own hiring control systems to prevent such bad actors from being on-boarded in the first place.

Regulatory Reporting

Regulators took the opportunity through this consultation to seek insight into practices around the reporting of new and cancelled or expired E&O insurance policies. A mortgage broker industry respondent summarized the view of many others as: “We believe that both new and cancelled policies should be reported by the insurer to the regulator. It is administratively difficult to notify regulators of cancelled policies in advance of the policy being cancelled because in many cases the policy is reinstated before the cancellation is processed. The primary reason why policies are cancelled is due to non-payment.” While there were generally no concerns with current requirements, one insurance industry respondent made the point that “Consistency in reporting requirements and procedures across the provinces would ease the administration.” In any event, all respondents noted that the situation would become more complicated if an individual E&O policy regime was introduced.

MBRCC Observations: While there were no issues raised about the current reporting requirements, all respondent groups generally wanted to see any administrative obligations shifted to another party. Insurers should ensure that they are following their statutory obligations about reporting in the jurisdictions where they insure mortgage brokerages.

Conclusion

The results of the E&O Committee's research and the response from the two consultations with regulators, insurance and mortgage broker industry respondents indicate that, while industry trends are testing current minimum coverage requirements, at this point E&O coverage seems to be adequate and no urgent changes are required at this time. Regulator respondents did not report being aware of any situations where coverage was inadequate. While increased E&O coverage could result in increased consumer protection, this must be balanced with maintaining an open and fair marketplace. Several insurers who offer E&O insurance policies for mortgage brokerages indicated that this is a non-target class for their business. There appears to be some legitimate concern for all respondents about maintaining the availability and affordability of this type of insurance product. The E&O committee notes that the findings presented here are valid as of Spring 2019 and recommends that the MBRCC continue to periodically assess this issue in order to proactively make recommendations when regulatory requirements or market conditions should change.

Regulators observed an apparent lack of clarity or understanding by the mortgage broker industry respondents about a number of insurance issues, in particular private lending. It is important that insurers and their intermediaries make an effort to increase their understanding of the mortgage broker industry and its professional liability needs and undertake to better educate their clients about availability of coverage and policy limits and exclusions.

At the same time, the mortgage broker industry could undertake better risk management to deal with the more common causes of loss, as discussed above. Another way is to adopt best practices related to purchasing insurance coverage, such as:

1. Engage early and regularly with insurance representatives, ask questions to understand if the product they are purchasing is suitable for their mortgage brokerage;
2. Do not just buy the minimum coverage required by law; make sure that the limits provide the coverage needed for their mortgage brokerage. To ensure adequate coverage, review the mortgage brokerage's business—average loan size, type of business (borrowers—residential, commercial or investors—private, syndication) and characteristics of brokerage (number and value of mortgages placed, number of licensees, supervision, policies and procedures); and
3. Make sure the coverage includes and is suitable for the mortgage brokerage's business activities before getting involved in activities such as private lending or mortgage syndication.

Another theme that emerged through the consultations was the desire by all market participants for more regulatory harmonization, in legislation and practice. For example, while we are close, a national standard on per occurrence and annual aggregate policy limits or for

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the length of ERPs might be places to start. Market participants should note that a best practice for regulators is to harmonize to the highest standards in existence, rather than to the lowest common denominator. This is an area where harmonization is warranted and in the direct control of regulators versus legislators.

The E&O Committee thanks all those regulators, mortgage and insurance industry respondents that thoughtfully contributed to its consultations.

Appendix A – Comparative Jurisdictional E&O Insurance Requirement Analysis

Province	E&O Req.	Amounts	Fraud Coverage	ERP Trailer	ERP/Trailer Duration
British Columbia	✗	NA	✗	✗	NA
Alberta	✓	\$500K/incident \$1M/year	✓	✓	-12 months if insurer cancels/does not renew -60 days if insured cancels or ceases operations
Saskatchewan	✓	\$500K/incident \$1M/year	✓	✓	-12 months if insurer cancels/does not renew -60 days if insured cancels, does not renew or does not replace policy
Manitoba	✓	\$500K/incident \$1M/year	✓	✗	NA
Ontario	✓	\$500K/incident \$1M/year	✓	✓	-12 months if insurer cancels/does not renew -60 days if insured cancels, does not renew or does not replace policy
Quebec	✓	\$1M/incident \$2M/year	✓ ³	✓ ⁴	-indefinite period (no defined limit on trailer coverage)
New Brunswick	✓	\$500K/incident \$1M/year	✓	✓	-6 years following merger, dissolution or cessation of brokerage or administrator ⁵
Nova Scotia	✗	✗	✗	✗	NA
Newfoundland & Labrador	✗	✗	✗	✗	NA

³ Fraud is covered through a civil liability fund administered by the OACIQ (Fonds d'indemnisation du courtage immobilier). Covers fraud, fraudulent acts and misappropriation of funds.

⁴ Mandatory professional liability insurance for errors and omissions provided by a special fund: Fonds d'assurance responsabilité professionnelle du courtage immobilier du Québec (FARCIQ).

⁵ Currently exempt by [Blanket Order](#)