DUTY CALLS

FIDUCIARY DUTIES OF A MORTGAGE BROKER

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Agency relationships in the mortgage context are complicated and, if not paid careful attention to, can expose brokers to significant legal consequences. Mortgage brokers can be an agent for either the borrower in a loan transaction, the lender, or both (i.e., a dual agent). An agent is a person who represents another person, called the principal, in dealings with third persons.[1] In situation of mortgage brokers, being an agent includes certain obligations called fiduciary duties.[2] These duties include, but are not limited to, the following:

- Loyalty and undivided service – refrain from dual agency without full disclosure of both parties and their knowledge and consent.[3]
- Avoid conflict of interest.[4]
- Cannot undertake acts adverse to the client.[5]
- Must keep client's property separate and identified.[6]
- Fullest disclosure of all material facts concerning the transaction that might affect the client's decision.[7]
- Disclose all offers to buy the property.[8]
- Act in the highest good faith towards the principal, but precludes the agent from obtaining any advantage over the principal by virtue of the agency.[9]

Dual agency

One area where a broker can run into trouble with a fiduciary duty is a dual agency. In a mortgage context, this can happen when one mortgage broker represents both the borrower and the lender. This is only allowed if both clients have knowledge of the dual agency, and consent to it. A best practice would be to disclose the dual agency in writing, and get both the borrower's and the lender's written consent to the dual agency. But, even if disclosed, a broker must be very careful not to violate the fiduciary duties owed to both parties.

Acts adverse to the client

One pitfall for the unwary is when a mortgage broker represents the borrower in a transaction and fails to delineate in writing when the agency ends. If that mortgage broker goes on to service the loan, the borrower could argue that the mortgage broker is still their agent. In which case, the mortgage broker would be open to liability for breach of their fiduciary duty if they were to foreclose on the borrower, because that would be an act adverse to the borrower. There is also a failure to disclose the dual agency with the borrower and lender that is also a problem.

Trust accounting

The duty to keep the client's property separate and identified is critical, and by following the Department of Real Estate trust accounting rules, the mortgage broker can fulfill this duty.

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[1] California Civil Code § 2295
[2] *Michelson v. Hamada* 29 Cal. App. 4th 1566, 1579 (1994).
[3] California Civil Code § 2322(c), California Probate Code § 16002.
[4] California Civil Code § 2322(c), California Probate Code § 16004.
[5] California Civil Code § 2322(c), California Probate Code § 16005.
[6] California Civil Code § 2322(c), California Probate Code § 16009.
[7] *Wyatt v. Union Mortgage Co*., 24 Cal. 3d 773, 782 (1979); (1968); *Rattray v Scudder*, 28 Cal 2d 214,223 (1946);.
[8] *Loughlin v. Idora Realty Co*. 259 Cal. App. 2d 619, 629.
[9] *Wyatt v. Union Mortgage Co*., 24 Cal. 3d 773, 782 (1979);

Disclosure of all material facts
The fact that the mortgage broker is making money or other compensation as a result of the transaction with the client is ALWAYS material. An agent can make no secret profits in a fiduciary relationship. When dealing with lenders, it is a best practice to disclose the "hair" on the deal, or the negative issues regarding the loan, in writing to the lenders prior to accepting their investment in the loan.

Disclose all offers – If you are a mortgage broker, like me, who never was a real estate agent helping people buy and sell properties, you may not be aware of this obligation. But it can arise in an REO (Real Estate Owned i.e. when the property reverts back to the lender at a foreclosure sale) context, when title to the property reverts back to the mortgage broker's lenders at the trustee's sale, and now the property is listed for sale. If the mortgage broker is the agent for the lenders, they must disclose all offers to the lenders.

Duty of highest good faith and no advantage over the client
Many times, this duty is tied together with the duty to disclose all material facts about the transaction. For example, if a loan is in default, and the broker knows that a colleague is about the make a loan to pay off the defaulted loan, but the lender on the defaulted loan does not know this fact, the broker cannot offer to buy the defaulted note at a discount from the lender without first disclosing all the facts known to them. Another area of risk for a broker is in advising a lender on what to bid at a foreclosure sale. A broker could be held to a higher duty of care because of the special expertise they are expected to have in real estate matters.[10] Likewise, in an REO context, if a broker representing the lenders and now owners of the foreclosed property has knowledge of an interested buyer for the property at a price well above the listing price, the broker cannot buy the property from the lenders at the listing price without disclosing their knowledge about the buyer at the higher price.

It is because of these fiduciary duties, and the potential liability that goes along with them, that mortgage brokers seek to avoid creating an agency when one is not intended. Documenting whether an agency relationship exists or not, as well as the scope and end-date for the relationship, is an important first step. The next step is to avoid doing or saying things that give the appearance of an agency relationship when none should exist. If there is an agency, understand your duties. And remember this: few fiduciaries were successfully sued because they over-disclosed the facts of a transaction, unless they hide important disclosures in a large document of boilerplate disclosures. If you're not sure if you should disclose, you probably should. Properly documenting the agency is not that difficult, but because mortgage brokers often operate with different business models, sometimes even within the same organization, one size does not fit all. It is a good idea to seek the advice of knowledgeable counsel to make sure your forms reflect your business operations and agency relationships (or that there is no agency relationship).

If you have any questions about this topic, please feel free to contact Michelle Rodriguez at mrodriguez@wrightlegal.net.

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[10] *Easton v. Strassburger,* 152 Cal. App. 3d. 90, (1984).