Plain Language Mortgage Documents CBA Commitment

Prepared by the Canadian Bankers Association

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CANADIAN BANKERS ASSOCIATION

Building a Better Understanding

Our commitment: Plain Language Mortgage Documents

Members of the Canadian Bankers Association are committed to providing customers with banking information which they can easily understand and use. This commitment led us to work together to explore how to apply plain language writing principles to residential mortgage documents.

We know that plain language makes sense for our customers. And, it also makes sense for us — saving staff time by eliminating confusion and improving communication within our organizations and with our customers.

This paper describes our shared promise to continue to improve the readability of residential mortgage documents. As well, it gives a few examples of how applying plain language principles could make typical mortgage documents easier for customers to use and understand.

It is up to each financial institution to write its own mortgage documents to address the needs of its customers and to explain its mortgage products. Plain language mortgage documents do not all look alike, but they will reflect attention to some basic plain language writing principles.

Plain Language Writing Principles

Plain language legal drafting is a new area of legal work that has emerged during the last thirty years. Its practitioners follow these basic writing principles:

- write to be understood
- help readers to find the information they want by using reader aids, for example, headings, notes in the margins, a table of contents, or a different print style to highlight key points
- use words that are familiar to readers and, when that is not possible, define legal and technical terms
- give an example or illustration to explain a complex concept or calculation, as appropriate
- print the document in an easy-to-read format, with an appropriate type size, print style and page design.

The bottom line in plain language legal drafting is:

> **“Is the writing and design clear so that readers can find and understand the information they need easily?”**

Customer feedback will be the best way for financial institutions to know if residential mortgage documents adequately reflect plain language writing principles.

Mortgage documents: important consumer contracts

A residential mortgage enables a person to buy a home when he or she does not have the savings needed to pay the full price at the time of the purchase. The lender provides money for the purchase and protects the loan by maintaining rights in the property through a mortgage.

Borrowers must sign or receive a number of legal documents related to a mortgage. Three of the most important are:

- A *Cost of Borrowing Disclosure Statement* sets out all the financial terms of the mortgage — the amount of the loan, the interest rate, the schedule for repaying the loan, etc.
- A *Mortgage Contract* sets out the obligations of the borrower and of the lender and describes what will happen if the borrower fails to make mortgage payments as required.
- A *Mortgage Renewal* sets out the interest rate and other terms at which a mortgage can be renewed, when a mortgage reaches it maturity date before the loan has been paid off in full.

These are the three mortgage-related documents which we believe are the most important to provide to our customers in plain language.

Plain Language Writing: Principles in Action

We cannot easily change the complex legal rules that apply to financial institutions and to the agreements we sign with our customers. These rules have evolved over centuries and are embedded in laws and regulations and in court decisions. However, we believe that we can work within our own institutions to improve the way that these rules are communicated to our customers.

Although each financial institution must develop its own documents to reflect the specific terms on which it is loaning money, we would like to offer a few examples to illustrate how plain language writing principles could be applied to mortgage documents.

Writing style, type size and lay out make a difference to readers

Before
This is a clause from a traditional mortgage contract.

COMPOUND INTEREST

It is agreed that in case default shall be made in payment of any sum to become due for interest at any time appointed for payment thereof as aforesaid, compound interest shall be payable and the sum in arrears for interest from time to time, as well after a before maturity, shall bear interest at the Charge Rate, and in case the interest and compound interest are not paid on the next interest payment date after the date of default a rest shall be made, and compound interest at the rate aforesaid shall be payable on the aggregate amount then due, as well after as before maturity, and so on from time to time, and all such interest and compound interest shall be a charge upon the Charged Premises.

After
This is a sample plain language version of this clause.

Interest owing on late payments	If a regular mortgage payment is late, we calculate the extra interest you owe for being late every day, using the annual interest rate of your mortgage. You pay interest on both the principal and the interest portion of the payment that is late. When we receive a payment, we will deduct the interest charges for the late payment and the interest owing on the principal amount first, before any part of the payment is applied to reducing the principal amount. We may also decide to apply the late payment to other amounts you may owe, for example, property taxes.

Of course, it is not really fair to take material out of context, but the examples above show how both writing and design can affect readability.

Headings and side notes help readers to find information

This next example illustrates the value of headings and side notes in helping readers to find the information they are looking for quickly. A good side note not only leads readers to the information that they need but also provides a short summary of the main message in the accompanying text.

This example shows how a borrower's responsibility to insure the mortgaged property might be described in a mortgage contract.

Insurance

mortgaged property must be insured

1. The borrower must maintain insurance, without interruption, to cover the full replacement value of the mortgaged property until the mortgage is discharged. The insurance policy must contain provisions concerning the mortgaged property approved by the Insurance Bureau of Canada or by the lender.

The insurance must cover losses caused by fire, storm and other perils covered by a standard property insurance policy. The lender can require the borrower to get additional insurance. For example, the lender may require additional insurance to cover damage that may be caused by a sprinkler system.

insurer must meet lender's criteria

2. The borrower can choose the insurer of the mortgaged property, but the insurer must meet the criteria set by the lender.

borrower to provide information about insurance, if requested

3. The borrower must provide the lender with information about the insurer and the insurance coverage on the mortgaged property, when the lender requests it.

lender receives insurance money

4. The lender must be named as the loss payee in the insurance contract. The lender receives any insurance money paid for loss of or damage to the mortgaged property and can use the money to pay the mortgage debt, owing or due. The lender also has the right to decide whether or not the damaged mortgaged property should be rebuilt or repaired.

notify the lender of a loss or damage

5. The borrower must inform the lender of any property damage that may result in an insurance claim, within 15 days of a loss or damage to the mortgaged property.

lender has right to insure mortgaged property, charge borrower

6. The lender has the right to obtain insurance for the mortgaged property if the borrower fails to have any, or to have adequate insurance coverage, or fails to obtain the coverage from an approved insurer.

In this situation, the lender may declare the mortgage in default and require the borrower to reimburse, on demand, the insurance costs incurred by the lender, with interest. If this amount is not paid, the lender may add the insurance costs with interest to the total amount of the mortgage.

Clear design highlights the information readers most need

This example from a sample mortgage renewal notice illustrates a design style that makes it easy for readers to find the information they are most likely to want.

Your renewal options - Option A	You can renew your mortgage on these terms, which resemble the terms of your existing mortgage.
interest rate	x %
mortgage type	for example, 1 year closed
maturity date	xx.xx.xxxx
payment schedule	for example, monthly
regular mortgage payment amount	$ xxx including: property tax payments $ xx life/illness insurance premium $ xx
Amortization period	xxxx, year in which the mortgage will be paid in full based on these terms
first mortgage payment	Your new regular mortgage payments will follow the existing schedule and all other terms of your mortgage will remain the same. Your first payment will be due on xx.xx.xxxx.
initial here	_____ I want to renew my mortgage on the terms set out above.

Examples show readers how a complex concept or calculation works

Sometimes, the best way to communicate information is to explain it and then give an example to show how it works in practice. In the following example, the costs of paying off a mortgage debt early, before the mortgage maturity date, are explained; readers are offered a step-by-step formula to use; and then, an example illustrates a “typical” situation.

Costs of paying off all or some of your closed mortgage before the maturity date

costs of making a pre-payment

The cost of paying off all or some of the remaining principal amount of your closed mortgage before the maturity date is the higher of these two amounts:
(1) three months’ interest costs on the amount you want to pay
or
(2) the interest rate differential amount. This amount is the difference between your existing mortgage interest rate and the interest rate currently charged for a mortgage similar to yours, calculated for the remaining term of the mortgage less any discount you received on your existing mortgage. A mortgage similar to yours has a term that is closest to the remaining term of your existing mortgage.

how to estimate pre-payment costs

Here is how you can estimate the cost of paying all or some of the principal amount of your mortgage before the maturity date. The result you get will only be an estimate. We use a precise formula that credits you for the amount of principal you would have paid off each month.

3 months' interest costs

(1) To estimate the three months' interest costs

Change your yearly interest rate from a percent to a decimal. For example, 6% = .06; 12% - .12. Multiply this number by the amount you want to pay. Then, divide the result by 4. The answer is the estimated three months' interest costs.

Step 1: _____ (A) - amount you want to pay
_____ (B) - mortgage interest rate written as a decimal
_____ (C) - A x B = C

Step 2: _____ (D) - C ÷ 4 = D, estimated three months' interest costs

(2) To estimate the interest rate differential amount

interest rate differential

Follow these steps to estimate the interest rate differential amount.

Step 1: _____ (A) - annual interest rate on your mortgage
_____ (B) - current annual interest rate for a new mortgage with a term that is closest to the remaining term in your existing mortgage (less any discount you received on your existing mortgage)
_____ (C) - A - B = C, which is the difference between your existing interest rate and the current rate
_____ (D) - amount you want to pay off

Step 2: _____ (E) – number of months left until your mortgage maturity date
_____ (F) - (C x D x E) ÷ 12 = F, estimated interest rate differential amount

The estimate cost of paying off all, or some, of the principal amount remaining on your mortgage before the mortgage maturity date will be the larger number that results from the calculations in (1) and (2).

please contact us for the exact amount of making a pre-payment

Please contact us for the exact cost of paying off some or all of the principal amount of the mortgage before the mortgage maturity date. We can quickly give you the precise costs that apply to early payments with respect to your mortgage. The amounts you calculate in sections (1) and (2) are only estimates and are likely to be higher than the actual cost of pre-payment. Please ask us if you would like a copy of the formula that we use to calculate the interest rate differential.

Example

Here is an example to illustrate the cost of paying off a mortgage before the maturity date.

Fiona and Henry have a mortgage for a 5-year term. The interest rate is 9 per cent. The original amortization period was 20 years and there are 18 years remaining. They still owe $100,000. They have inherited $100,000 and are thinking of using it to pay off their mortgage. They have used all the pre-payment options available to them this year. There are 36 months left before the mortgage maturity date. The current interest rate for a mortgage with a similar term is 6 per cent.

Three months' interest costs

Step 1: $ 100,000 (A) - amount they want to pay
.09 (B) - mortgage interest rate written as a decimal
$ 9,000 (C) - A x B = C (100,000(A) x .09(B) = $9,000(C)

Step 2: **$ 2,250** (D) - C ÷ 4 = D, ($9,000(C) ÷ 4 = $2,250(D)
(estimated three months' interest costs)

Interest rate differential amount

Step 1:	9%	(A) - annual interest rate on the mortgage
	6%	(B) - current annual interest rate for a new mortgage with a term that is closest to the remaining term in their existing mortgage (less the discount received on their existing mortgage)
	.03	(C) - A - B = C, the difference between their existing interest rate and the current rate, written as a decimal
	$ 100,000	(D) - amount they want to pay off
Step 2:	36 months	(E) - number of months left until the mortgage maturity date
	$ 9,000	(F) - (C x D x E) ÷ 12 = F (.03(C) x 100,000(D) x 36(E)) ÷ 12 = $9,000
		estimated interest rate differential amount

In this example, Fiona and Henry estimate that it would cost them $9,000 to pay off their mortgage before the maturity date, since this amount is higher than the three months' interest costs. When Fiona and Henry check with us, they would get the exact cost of paying off their mortgage early. In their case, the exact cost would be lower than their estimated cost.

A formula representative of those used by the banks to calculate the interest rate differential looks like this:

$$IRD = \frac{P}{(1+r)} + \frac{P}{(1+r)^2} + \frac{P}{(1+r)^3} + \frac{P}{(1+r)^4} + \frac{P}{(1+r)^5} + \frac{P}{(1+r)^6} + \frac{P}{(1+r)^7} + \frac{P}{(1+r)^8} + \frac{P}{(1+r)^9} + \frac{P}{(1+r)^{10}} + \frac{P}{(1+r)^{11}} + \frac{P}{(1+r)^{12}} = \$ \_\_\_\_\_$$

You can appreciate why it is easier for readers to work with the above example rather than with the formula. In fact, when we asked a sample of readers in a controlled test setting to work with the example, we found that they could accurately figure out the three months' interest costs and the interest rate differential amount in a test question. They could not begin to work with the formula!

Plain language simply means writing so that readers can understand.

Consumers can expect to see changes

The members of the Canadian Bankers Association are making a commitment to plain language residential mortgage documents and are promising to take these steps:

1. We will conduct a plain language audit of our mortgage documents to identify if and how our documents need to be changed to reflect plain language writing principles.

2. We will develop a strategic plan and timetable for “translating” existing mortgage documents into plain language, if the existing mortgage documents do not reflect plain language principles. CBA members aim to have this process largely complete by 2005.

3. We will apply plain language principles when revising or developing new residential mortgage documents.

Each financial institution will have to decide how best to adapt their individual mortgage policies and documents to reflect this plain language commitment and the requirements of various jurisdictions. In fact, many consumers will already have noticed an improvement in the style of writing and the design of documents that they are receiving from us. We plan to continue to work on making our residential mortgage documents clearer and easier for our customers to read.

These changes cannot all happen overnight, but they will happen. Ultimately, consumers will be the real judges of whether or not we have met the commitment we have made in this paper.

Sample Cost of Borrowing Disclosure Statement

[financial institution]

This Statement sets out the amount of money we are loaning to you and the cost of borrowing it. We are required to provide this information to you before you sign your Mortgage Contract. Your signature on this Statement shows that you have received it.

Please keep a copy of this Statement to refer to later.

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mortgage number [mortgage number]

[borrower's name(s) and address]

We have approved your request for a mortgage on the property:

property description [lot number]

[street address]

A. Principal amount borrowed

principal amount borrowed [$] - This is the approved loan amount.

We will deduct the following amounts from the principal amount borrowed:

[$] - Mortgage default insurance premium

[$] - Other charges _____

available amount [$] - This is the amount we will advance according to your instructions.

[if applicable to borrower] [You may have to pay other costs related to your mortgage, separately. For example, we cannot deduct the default insurance application fee or the sales tax on the mortgage default insurance premium from the principal amount of the mortgage.]

B. Your mortgage term and amortization period

Your mortgage is: [type: closed, open, etc.]

mortgage term [months/years]

Interest Adjustment Date [date] This is the date on which your mortgage term starts.

interest owing on money loaned before the Interest Adjustment Date When we have loaned you all or part of the principal amount of your mortgage before the Interest Adjustment Date, you will owe interest for the time between the date the money was advanced and the Interest Adjustment Date. You must pay this interest monthly, with the final amount due on the Interest Adjustment Date.

maturity date [date] This is the date on which the term ends and on which you must repay your mortgage in full. Or, we may offer to renew your mortgage for another term.

amortization period [years] This is the time it would take to pay off your mortgage in full, based on the regular monthly mortgage payments and the interest rate set out in this Statement.

C. Interest rate

annual interest rate [interest rate] per year (including any discount)

calculation of interest owing Each regular mortgage payment you make repays part of the principal amount borrowed and pays the interest costs for the loan. So, the principal amount of the mortgage decreases with each regular mortgage payment and the portion of your payment needed to cover interest costs also decreases. Over time, when your payments are made on time, an increasingly larger portion of each regular mortgage payment goes towards repaying the principal amount you borrowed.

After each regular mortgage payment you make, we re-calculate the amount of interest you owe. We take the principal and interest amount owing from the previous payment date until this payment date. You owe interest on this amount at the annual interest rate, compounded half-yearly, not in advance. We add this interest amount to the principal amount. Then we use this new amount to calculate the interest owing on your next mortgage payment.

D. Regular monthly mortgage payment amount

monthly principal and interest amount

[$]

other monthly payment amounts

[$] - Property tax deposit (if applicable)

[$] - Illness and disability insurance premium (if applicable)

[$] - taxes on illness and disability insurance premium

[$] - Life insurance premium (if applicable)

[$] - taxes on life insurance premium

[$] - Other (specify) _____

total monthly payment amount

[$]

Please note that except for the property tax payment, you may cancel any service that you have requested, such as illness insurance, by giving us 30 days' notice in writing. After the cancellation date, we will refund any amount that you paid us in advance for the service you have cancelled.

E. Late payments and default charges

mortgage in default

This includes when you are late making a regular mortgage payment or when you do not make a scheduled payment. Your mortgage can also be in default for other reasons, such as failing to maintain adequate fire insurance on the property. The Mortgage Contract states all the ways in which your mortgage may be in default.

interest owing on late payments

If a regular mortgage payment is late, we calculate the extra interest you owe for being late every day, using the annual interest rate of your mortgage. You pay interest on both the principal and interest portion of the payment that is late. When we receive a payment, we will deduct the interest charges for the late payment and the interest owing on the principal amount first, before any part of the payment is applied to reducing the principal amount. We may also decide to apply the late payment to other amounts you may owe, for example, property taxes.

default charges

If your mortgage is in default for any reason, you will have to pay any or all of these amounts:

- the missed mortgage payment
- interest on the principal and interest amount of the missed mortgage payment, as described in this section
- costs, including legal fees and disbursements, resulting from any action we may take or which is taken on our behalf to try to collect the amount owing
- costs, including legal fees and disbursements, we may incur or which are incurred on our behalf to protect the property or to take action under the terms of the Mortgage Contract
- any amount charged to you according to the Mortgage Contract, and
- interest at the mortgage rate for any costs charged to you according to the Mortgage Contract.

calling the loan

If you are in default, we can also call the loan and require you to pay immediately everything you owe according to the Mortgage Contract.

F. Payment schedule and balance still owing at maturity

payment schedule

[date] This is the date your first regular mortgage payment is due.
[e.g. the 1st of the month] This is date your regular mortgage payments are due.

balance owing at maturity

[$] This is the principal amount that will still be owing on the maturity date, if all payments are made on time and you have not made any extra payments or other changes to the terms of your mortgage.

The information in this Statement is based on a regular monthly payment schedule. We invite you to discuss with us other payment arrangements, such as weekly payments.

signatures

_____ _____ _____
name of financial institution's representative | representative's signature | date

I have received this Cost of Borrowing Disclosure Statement.

_____ _____ _____ _____
borrower's signature | date | borrower's signature | date

_____ _____ _____ _____
guarantor's signature | date | guarantor's signature | date

How mortgages can be paid off early

When we loan you money, we are expecting you to pay it back according to the payment schedule in the Cost of Borrowing Disclosure Statement. You cannot pay off all or part of your mortgage early, except in the ways described below.

open mortgage

If you have an open mortgage and all your mortgage payments are up to date, you can pay off some or all of the principal amount owing at any time.

A. Extra and increased payments

closed mortgage

If you have a closed mortgage, you can only increase payments to pay off some of your mortgage early in one of these three ways:

pay up to 10% of principal amount

1. Once during each year of the term of your mortgage, you can reduce the principal amount of the mortgage by paying up to 10% of the original principal amount of the mortgage. The minimum payment you can make is $100.

extra payments

2. Once each month, on any regular payment date, you can make an extra payment up to the amount of a regular monthly payment. The minimum payment you can make is $100.

increase regular payment by up to 10%

3. Once during each year of the term of your mortgage, you can increase your regular monthly mortgage payment amount by up to 10%. The increase in the payment will be used to pay down the principal amount of the mortgage. When you increase your monthly payment, you must continue making the higher payment for the rest of the term or the rest of the year, whichever comes first. At that time, there are three possibilities:
   i) you can keep paying the increased payment for the new term, if it is less than 12 months, or for another year
   ii) you can increase your payment by up to another 10%, or
   iii) you can go back to the original regular monthly mortgage payment amount.

Please note that these three options are available each year, but cannot be reserved to use in a later year. If your mortgage term is less than a year, these options are available in each term.

mortgage must not be in default

To make an extra or increased payment, your mortgage must not be in default and you must have complied with all the terms of the Mortgage Contract.

B. Costs of paying off all or some of your closed mortgage before the maturity date

If your mortgage payments are up to date and you have complied with all the terms of the Mortgage Contract, you may, before the maturity date, pay off more than 10% of the principal amount of the mortgage as described in Section "A" above.

costs of making a pre-payment

The cost of paying off all or some of the remaining principal amount of your closed mortgage before the maturity date is the ***higher*** of these two amounts:

(1) three months' interest costs on the amount you want to pay

or

(2) the interest rate differential amount. This amount is the difference between your existing mortgage interest rate and the interest rate currently charged for a mortgage similar to yours, calculated for the remaining term of the mortgage less any discount you received on your existing mortgage. A mortgage similar to yours has a term that is closest to the remaining term of your existing mortgage.

Please note that before paying off some of the principal amount in the way described here, you can take advantage of the extra and increased payment options described in Section A.

how to estimate pre-payment costs

Here is how you can estimate the cost of paying all or some of the principal amount of your mortgage before the maturity date. The result you get will only be an estimate. We use a precise formula that credits you for the amount of principal you would have paid off each month.

3 months' interest costs

(1) To estimate the three months' interest costs

Change your yearly interest rate from a percent to a decimal. For example, 6% = .06; 12% = .12. Multiply this number by the amount you want to pay. Then, divide the result by 4. The answer is the estimated three months' interest cost.

Step 1: _____ (A) - amount you want to pay

_____ (B) - mortgage interest rate expressed as a decimal

_____ (C) - A x B = C

Step 2: _____ (D) - C ÷ 4 = D, estimated three months' interest costs

interest rate differential

(2) To estimate the interest rate differential amount

Follow these steps to estimate the interest rate differential amount.

Step 1

_____ (A) - annual interest rate on your mortgage

_____ (B) - current annual interest rate for a new mortgage with a term that is closest to the remaining term in your existing mortgage (less any discount you received on your existing mortgage).

_____ (C) - A – B = C, which is the difference between your existing interest rate and the current rate. Write C as a decimal. For example 6% = .06.

_____ (D) - amount you want to pay off

Step 2

_____ (E) - number of months left until your mortgage maturity date

_____ (F) - (C x D x E) ÷ 12 = F, estimated interest rate differential amount

The estimated cost of paying off all, or some, of the principal amount remaining on your mortgage before the mortgage maturity date will be the larger number that results from the calculations in sections B (1) and (2).

contact us for exact costs of making a pre-payment

Please contact us for the exact cost of paying off some or all of the principal amount of the mortgage before the mortgage maturity date. We can quickly give you the precise costs that apply to early payments with respect to your mortgage. The amounts you calculate in sections B (1) and (2) are only estimates and are likely to be higher than the actual cost of pre-payment. Please ask us if you would like a copy of the formula we use to calculate the interest rate differential.

Example

Here is an example to illustrate the cost of paying off a mortgage before the maturity date.

Fiona and Henry have a mortgage for a 5-year term. The interest rate is 9%. The original amortization period was 20 years and there are 18 years remaining. They still owe $100,000. They have inherited $100,000 and are thinking of using it to pay off their mortgage. They have used all the pre-payment options available to them this year. There are 36 months (3 years) left before the mortgage maturity date.

At this time, the bank is offering a new 3-year mortgage at an interest rate of 6%. Here is how much Fiona and Henry estimate it would cost them to pay off their mortgage now.

Three months' interest costs

Step 1

$100,000 (A) - amount they want to pay

.09 (B) - mortgage interest rate expressed as a decimal

$9,000 (C) - A x B = C, $100,000 (A) x .09 (B) = $9,000 (C)

Step 2

$2,250 (D) - C ÷ 4 = D, ($9,000 (C) ÷ 4) = $2,250 (D)
estimated three months' interest costs

Interest rate differential

Step 1

9% (A) - annual interest rate on the mortgage

6% (B) - current annual interest rate for a new mortgage with a term that is closest to the remaining term in their existing mortgage

.03 (C) - A – B = C, the difference between their existing interest rate and the current rate, written as a decimal,
9% (A) – 6% (B) = 3% (C) = .03 (C)

$100,000 (D) - amount they want to pay off

Step 2

36 months (E) - number of months left until the mortgage maturity date

$9,000 (F) - (C x D x E) ÷ 12 = F, (.03 (C) x $100,000 (D) x 36 (E)) ÷ 12 = $9,000 (F),
estimated interest rate differential amount

In this example, Fiona and Henry estimate that it would cost them $9,000 to pay off their mortgage before the maturity date, since this amount is higher than the three months' interest costs. When Fiona and Henry check with us, they would get the exact cost of paying off their mortgage before the maturity date. In their case, the exact cost would be lower than their estimated cost.