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Lawsuits could mean mortgage refunds

Banks allegedly overcharged on early payouts

Anyone charged a penalty since 1997 could be affected

Homeowners who paid off their mortgages early within the last seven years and got zapped with a prepayment penalty, could be in line for a refund if a series of class actions now underway is successful.

The litigation began when Stewart Gregg, a civil servant in Ottawa, claimed he was over-charged on a prepayment penalty after paying off his mortgage before its maturity date. He approached Ottawa real estate lawyer John Farah.

Most mortgage contracts allow the borrower to prepay 10 or 20 per cent of the principal without penalty once a year. But when most banks provide discharge statements for early payouts, they calculate the penalty on the whole amount outstanding. Typically, they do not allow the borrower to prepay the 10 or 15 per cent before the penalty is calculated.

In effect, the penalty is calculated on all of the principal outstanding rather than the balance after allowing the borrower to prepay part of the mortgage without penalty.

Farah and Kirk Baert, of Toronto's Koskie Minsky, have launched 11 class actions against Canadian banks and financial institutions for overcharging borrowers on prepayment penalties.

Named as defendants in 10 of the class actions are Bank of Montreal, CIBC, Scotiabank, National Bank, TD Bank, Canada Trust, Laurentian Bank, HSBC Bank Canada, Industrial Alliance and London Life. None of the cases has gone to trial yet, and none of the allegations has been proven in court.

Conspicuously absent from the list is Royal Bank, which correctly charged borrowers a penalty based on the balance after the prepayment privilege amount was deducted.

Last week, the Civil Service (CS) Co-op in Ottawa settled the case against it rather than go to trial. The Co-op has agreed to pay \$147,329 to about 775 customers who were overcharged on early mortgage payouts.

Before any of the remaining cases goes to trial, they have to be certified as a class action. Baert and his team are handling the certification applications, which are expected to be heard in the fall.

Farah estimates about 200,000 Canadians were overcharged on their mortgages since 1997. Payments made before that are past the limitations period and are ineligible for refund. If other banks follow the lead of the CS Co-op in Ottawa, refunds could exceed \$100 million.

"This settlement is good news for Canadian homeowners," Farah says. "It's right in the contract that customers are entitled to pay off a part of their mortgage without a penalty. It seems that unless you remind the bank or ask them for your credit when you pay out your mortgage in full, the savings are lost. I don't think that's right."

Banks usually calculate prepayment penalties based on whatever is greater: three months' interest or an interest rate differential between the rate the borrower is paying and what the bank could reinvest the money at when the prepayment is made.

The difference to homeowners can be substantial. For example, if a homeowner had \$200,000 owing on a mortgage, and a mortgage interest rate of 7 per cent, the three-month penalty charged by the financial institutions would be \$3,500. However, if the bank credited the homeowner with the 15 per cent penalty-free prepayment, the balance owing would be reduced to \$170,000 and the three-month interest penalty would be just \$2,975 a savings of \$525.

Those penalized since 1997 are automatically included in the lawsuits. The banks have all the records it's not necessary to sign on as a plaintiff.

It would be wise, however, for potential participants to contact their lenders (or former lenders) and advise them of current contact information. As well, interested consumers can sign up for free e-mail updates at <http://www.bankclassaction.com>.

Samples of the statements of claim by the representative plaintiffs and the statements of defence by some of the banks are posted on the Web site of the plaintiff's counsel. Visit <http://www.farahandassociates.ca> and click on Class Action.

Anyone planning to pay off a closed mortgage before its maturity date in the future should carefully review the discharge statement to ensure that the penalty was calculated on the balance after the penalty-free discount was deducted.