MORTGAGE PROFESSIONALS CANADA

PROFESSIONNELS HYPOTHÉCAIRES DU CANADA

Public consultation on guideline B-20:
Residential Mortgage Underwriting Submission

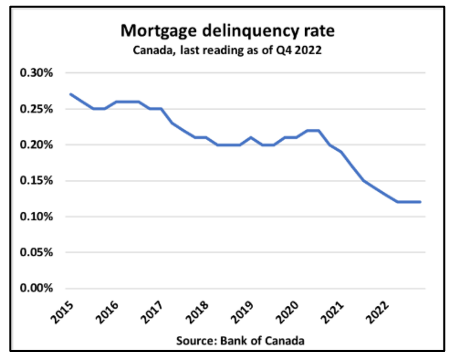
April 2023

Introduction

Mortgage Professionals Canada (MPC) on behalf of its 15,000 members, is committed to improving housing affordability, and helping Canadians from coast-to coast-to coast achieve the dream of homeownership. We are also committed to ensuring that the voices of our membership, the mortgage industry, and above all Canadian home buyers, are heard.

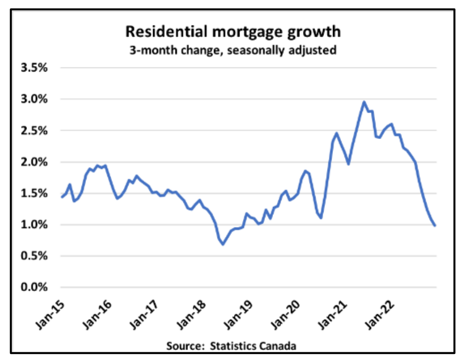
We appreciate the initial engagement we have had with the Office of the Superintendent of Financial Institutions and the receptivity for stakeholder consultation and feedback. As an industry, we understand the importance of ensuring the credit quality of residential mortgage assets and assessing the underwriting practices of federally regulated institutions, many of which are our members.

We support Principle 3 of guideline B-20, which indicates that FRFIs should adequately assess borrower capacity to service their debt obligations on a timely basis. The existing stress test has achieved what it was designed to do. It is a prudent measure that has protected borrowers from financial vulnerability at a time of historically low interest rates. It helped prepare Canadians for the rapid rise in rates that we experienced this year, and could be a contributing factor as to why delinquency continues to hover at historical lows.



Mortgage arrears in Q4 2022 were 0.12% according to the Bank of Canada. That figure was unchanged from Q3, and it remains a third of the 0.35% average reported by the Canadian Bankers Association since 1995.

According to Statistics Canada, residential mortgage growth in the three months ending in December 2022 had slowed to just 1.0%. That was the lowest growth rate since 2018 in the immediate adjustment to the initial implementation of guideline B-20.



Capital Framework

The collapse of Silicon Valley Bank (SVB) has had ripple effects across the global financial sector. Despite concerns this event may impact the Canadian economy, Canada's strong banking sector and the regulatory bodies that underpin it provide assurances against the prospects of broader contagion in Canada. The diverse asset base of Canada's banking system coupled with the world's premiere regulatory system limits systemic risk in Canada. The SVB situation highlights the importance of an effective regulatory system, healthy balance sheets and the strong reputations of Canadian banks to protect businesses and consumers. Canada's big six banks are systemically important due to the critical role they play in the Canadian economy and safeguards are in place to ensure they are well capitalized and hold adequate liquidity to respond to crises.

We appreciate that Canadian regulators such as OSFI and the Bank of Canada must ensure that Canadian federally regulated institutions are well capitalized and have buffers in place to absorb shock liquidity positions, however we believe this goal can and should be balanced with the risks to Canadian consumer confidence at a time when Canadians are facing economic challenges due to inflationary pressures and high interest rates. The Canadian lending industry is well equipped to handle the impact of worsening economic conditions as Canadian banks for example, have set aside capital to deal with potential credit and loan losses. Canadian federally regulated financial institutions have also shown flexibility for consumers who are vulnerable to mortgage delinquency as a result of exceptional circumstances, such as temporary extension to the amortization period and waiving internal fees and costs when activating mortgage relief measures. We welcome the work that the Financial Consumer Agency of Canada is engaged on in developing a guideline for consumers facing difficult circumstances as a result of the higher cost of living due to inflation and higher interest rates.

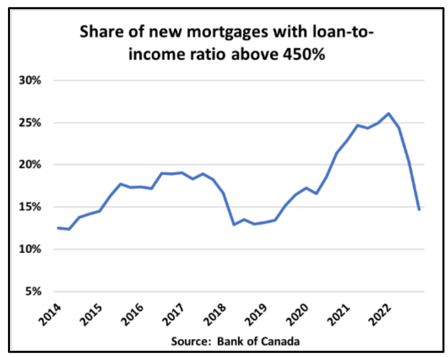
As indicated in a Bank of Canada staff analytical note:

" The global financial crisis of 2008–09 significantly disrupted financial intermediation and ultimately exposed US taxpayers to losses from bank failures (Bernanke 2018). Regulatory authorities throughout the world responded by asking whether they should impose additional capital requirements on banks and, if so, in what form (BCBS 2010a).

The decision to impose such regulation is complex and involves important trade-offs. For instance, increasing minimum capital requirements on banks may help reduce losses during bank failures, but it could also constrain banks from providing credit when it is most scarce. During financial crises, limiting credit could amplify the downturn and impair the economic recovery." (Bank of Canada, June 2021)

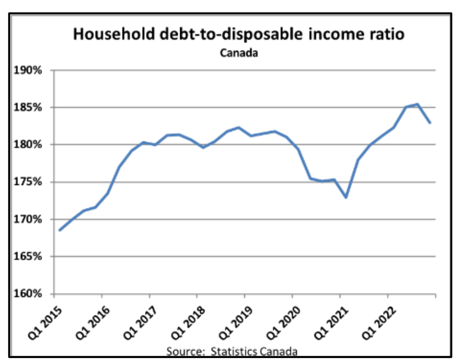
Lender Volume Restriction on High LTI Lending

The consultation document indicates that mortgage lending risks, particularly related to debt serviceability have increased considerably since the onset of the pandemic. One proposed measure to address this is to seek stakeholder input on a specific proposal to adopt a high LTI threshold of 4.5X, which would apply on the total value of quarterly originations.



However, the share of highly indebted new borrowers has fallen sharply in recent quarters. Fewer than 15 per cent of new mortgages had loan-to-income ratios above 450 per cent in Q4 according to the Bank of Canada.

In addition, household disposable income growth was 3.0 per cent in the fourth quarter, nearly triple the rate of mortgage growth which had slowed to 1.0 per cent, according to data from Statistics Canada. As a result of income growth outpacing mortgage growth by a factor of 3, households are now deleveraging.



In Q4, the household debt-to-disposable income ratio fell to 183 per cent from 185 per cent in the prior quarter. Outside of Q2 2020, that represents the largest quarterly decline in this ratio since 1990.

On the average, loan to income is declining sharply as the average salary is increasing much faster than debt and home prices have declined, thus mortgage amounts on purchase transactions are declining. The timing to regulate and bring down higher loan to income is off, as it has almost already returned to pre-pandemic levels.

Three OECD countries have a loan to income limit instead of a debt service to income ratio in place: Ireland, Norway and the United Kingdom. All of these countries allow a certain share of new lending to exceed these caps (OECD Economics Department Working Papers: Mortgage finance across OECD countries, December 2021). In 2022, the Bank of England withdrew its interest affordability stress test which had been in place since 2014. The Bank of England's Financial Policy Committee judged in late 2020 that most banks had capital buffers in place that allowed them to operate and remain resilient to a wide range of possible outcomes for the United Kingdom and global economies (Financial Policy Summary and Record, December 2021, Bank of England).

If such a restriction were to be put in place, though we feel it unnecessary at this time given the data and arguments presented earlier in this section, we would recommend that at the portfolio level a guidance should be provided to suggest FRFIs have no more than 10 per cent of their total portfolio exceed the LTI threshold. This would be an ongoing measure that is tracked to allow regular adjustments, allowing for quarterly measures but with an annual requirement. It should be based on loan count and not volume as to not skew numbers for lenders that do larger loans or loans in larger urban areas. For smaller lenders or lenders with a higher percentage of their book being default insured (over 50 per cent), we suggest the threshold for the exception be higher, closer to 20 per cent.

Debt Service Restrictions

We believe that the current approach to debt serviceability is working. While GDS and TDS formulas work most of the time and lenders endeavour to have a reasonable distribution across their portfolios, there are mitigating factors in many cases where GDS and TDS ratios are above 39 and 44 per cent respectively, such as assets which are not counted when assessing GDS and TDS.

While the Bank of Canada had noted in its *Financial System Review 2021* that two key household vulnerabilities were high household indebtedness and imbalances in the housing market, households are now deleveraging with disposable income growth increasing at nearly triple the rate of mortgage growth, as mentioned previously in this submission.

GDS and TDS are often not the best predictors of risk, in the way that a credit score or credit utilization would be, as in most instances the risk is mitigated by factors such as household savings or investments. Many purchases with higher than average loan to income in the Greater Toronto and Greater Vancouver areas for example, have borrowers with high credit scores, most with two or more applicants, and those factors are much more predictive of risk than GDS/TDS ratios.

Interest Rate Affordability Stress Tests on Non-Consumer Debt

The MQR or a similar interest rate affordability stress test should not be applied to a borrower's total debt services. We believe OSFI should consider other measures to restrict non-mortgage consumer indebtedness outside of the mortgage qualification process. Introducing additional requirements and assessments when calculating gross debt service is not required, as mortgage delinquency does not appear to be as large of a risk as the risks posed by the increase in higher interest and unsecured non-mortgage related consumer debt.

Mortgages account for the safest of all credit products for federally regulated financial institutions. Consumers with a mortgage are less likely to miss a non-mortgage payment, according to Equifax Canada.

Despite the continuing market concerns of rising interest rates for homeowners, according to data from Equifax, consumers without a mortgage that saw the greatest jump in missed payments during the fourth quarter of 2022. Compared to the 12 months prior, the proportion of non-mortgage consumers who missed a payment on a credit product increased by 11 per cent in the fourth quarter of 2022. In the same period, consumers with a mortgage only saw a 6 per cent rise in their proportion of missed non-mortgage payments. The risks of delinquency are much higher for non-mortgage holding consumers who hold unsecured, higher interest debt.

To place further restrictions on mortgage qualification would mean that consolidation loans would be moved to higher risk, higher rate products and will impact the overall financial health of all Canadians, and not have the desired impact. Rather, more rules should be put in place for credit card lending and unsecured debt lending as many Canadians are carrying increasingly high balances.

Mortgage delinquency rates continue to hover at historical lows in Canada. Ontario and British Columbia, the two jurisdictions with the highest home prices experience the lowest arrears, at 0.07 per cent and 0.12 per cent respectively as of January 2023, according to data from the Canadian Bankers Association.

CANADIAN BANKERS ASSOCIATION — DB50 PUBLIC

Number of Residential Mortgages in Arrears

Month Ended January 31, 2023			
LOCATION	Total Number of Mortgages	Number of Mortgages in Arrears*	% of Arrears to Total Number of Mortgages
ATLANTIC	351,406	875	0.25%
QUEBEC	959,505	1,094	0.11%
ONTARIO	2,200,950	1,648	0.07%
MANITOBA	123,669	366	0.30%
SASKATCHEWAN	131,966	843	0.64%
ALBERTA	604,470	2,246	0.37%
BRITISH COLUMBIA	717,754	837	0.12%
TERRITORIES	10,728		
CANADA	**5,100,448**	**7,909**	**0.16%**

Includes data from BMO, CIBC, HSBC Bank Canada, National Bank of Canada, RBC Royal Bank, Scotiabank, TD Canada Trust, Canadian Western Bank, Manulife Bank (as of April 2004), Laurentian Bank (as of October 2010), Equitable Bank (as of November 2020)

* Mortgage arrears is three or more months

** Data for Yukon included in British Columbia. Data for NWT and NU included in Alberta.

A potential new restriction on debt service lending or potential new loan to income restrictions, will provide Canadians with less options, pushing mortgage loans down the credit curve to more costly and higher risk loans, which in the long term has a higher cost to all Canadians and a higher likelihood of overall mortgage delinquency due to the increased cost. Borrowers who are coming up for renewal will also be less likely to have options to move lenders. We believe the existing guidelines and stress test, have protected federally regulated financial institutions and consumers from delinquency during the most significant of financial crises, COVID-19 and the recent interest rate increases.

Concerns should be more focused on the increase in consumer credit card debt and other unsecured debt rather than the mortgage qualification process. Equifax Canada reported in March that total consumer credit card balance showed a year-over-year increase of 15.3 per cent, and crossed $100 billion for the first time. High volume of new cards also contributed to the overall balance growth with over 1.4 million new cards issued in the last three months.

Impact of Proposals

Introducing further restrictions in the context of a heightened rate environment creates the risk conditions of pushing average Canadians out of the federally regulated system and into riskier and more costly mortgage solutions. This is also a concern for provincial regulators, such as the Financial Services Regulatory Authority of Ontario (FSRAO) which has indicated that "recent economic and market uncertainty, significant home price appreciation and more stringent underwriting criteria introduced by OSFI for federally regulated lenders have made it more difficult for consumers to obtain or maintain mortgages with traditional lenders. As a result, more consumers are turning to alternative and private mortgage financing options." FSRAO indicates that some of these consumers tend to be more financially vulnerable and could be taken advantage of in private mortgage transactions. (Mortgage Brokering Supervision Plan 2021-2022).

If qualification requirements become too stringent for the average Canadian borrower, there is a risk of creating a federally regulated financial system that privileges the select few who are able to qualify for a loan at a federally regulated institution, while more Canadians are pushed to costly, riskier mortgage solutions. This works against the mandate laid out in the *Blueprint for OSFI's Transformation 2022-2025* to place greater emphasis on contributing to public confidence in the Canadian financial system.

Furthermore, additional restrictions in the current market context could exacerbate the growing concerns of mortgage fraud. Equifax Canada recently warned of the anticipated increase in mortgage fraud due to the increased difficulty in qualifying for a mortgage. Fraud has increased by 29.5 per cent in Canada since the start of the pandemic, according to recent data from Equifax published in November 2022.

About Mortgage Professionals Canada

We are Canada's mortgage industry association with over 15,000 members and more than 1,000 member firms. We are a non-profit association representing mortgage brokers and agents, as well as banks, lenders, insurers, and service providers, making up the largest network across the country. Forty-five per cent of first-time home buyers in Canada choose brokers for their mortgage.