Office of the Superintendent of Financial Institutions Canada
Bureau du surintendant des institutions financières Canada

Reference: Advisory Capital Requirements for Federally Regulated Mortgage Insurers

December 15, 2016

To: Federally Regulated Mortgage Insurers

Subject: Advisory Capital Requirements for Federally Regulated Mortgage Insurers

OSFI is releasing the final advisory, *Capital Requirements for Federally Regulated Mortgage Insurers* ("Advisory"). This Advisory will come into effect on January 1, 2017 and replace the advisory *Interim Capital Requirements for Mortgage Insurance Companies*. The Advisory defines a new standard approach for the regulatory capital requirements for mortgage insurance risk. Along with Guideline A - *Minimum Capital Test*, the Advisory defines the framework within which the Superintendent will assess whether a mortgage insurer maintains adequate capital.

On September 23, 2016, OSFI published a draft version of the Advisory for public consultation. A non-attributed summary of the comments received along with OSFI's responses is provided in Appendix I. OSFI appreciates the time, assistance, and support of the industry in developing the new capital framework, and would like to thank everyone who provided comments on the draft version of the Advisory during the consultation period. OSFI is open to continuing these discussions and considering any new information in the coming years.

After reviewing the comments received and following additional discussions with the industry, OSFI has made the following modifications to the Advisory:

- Transition arrangements have been introduced with respect to the use of borrower credit scores.
- Formulas have been added for determining the requirements when the term of insurance is five years or less.
- Formulas for determining the supplementary capital requirement have been simplified and recalibrated.

In addition, edits to the text have been made in certain places to improve clarity and readability.

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Should you have any questions, please contact Michael Bean, Managing Director, Capital Division by email at michael.bean@osfi-bsif.gc.ca or by telephone at (416) 954-0503.

Sincerely,

Jeremy Rudin
Superintendent

Attachment

Appendix 1 – Summary of comments from public consultation and OSFI responses

Topic	Comments	OSFI Response
General Comment	All of the submissions expressed support for having an updated, more risk-sensitive capital framework.	Noted.
Relativities of Requirements with Respect to loan-to-value (LTV) Ratio, Overall Level of Requirements	The requirements for lower LTV mortgages are higher than recent experience would suggest. Relativities of requirements with respect to LTV should be revisited to ensure capital appropriately reflects the legal foreclosure process and related settlement timeframe in each province.	When comparing the requirement for one LTV versus another, it matters whether the property value is held constant or the loan balance is held constant. The relative requirements that naturally flow from the new capital framework assume that the loan balance is constant. When these relativities are adjusted to the more commonly used basis, i.e., property value held constant, they are much greater than they at first appear. It is also important to note that relativities with respect to LTV in the new framework change as the mortgages age. In particular, the requirements for lower LTV loans decline much more rapidly than those for higher LTV loans. Hence, considering only the relativities at origination gives a distorted view of the capital needed to support lower versus higher LTV mortgages, particularly for a seasoned portfolio of mortgages.
	If the requirements were calibrated based on the recent US recession experience, then they may be overstated due to a lack of a sub-prime market, better regulation and practices, and more efficient claims processing in Canada.	The US recession experience has not been used to determine any assumptions or calibrate the model used to determine the requirement formulas.
	The framework will likely result in higher mortgage insurance premiums. Since premiums do not differ across the country, this may result in less risky housing markets supporting risker housing markets in other parts of the country.	Consistent with its prudential mandate, OSFI's focus when designing the new capital framework has been on capital adequacy and policyholder protection. It is the companies' responsibility to set premiums based on their assessment of risk and other factors. The new framework is designed to be more risk sensitive and to provide appropriate incentives to the companies. It is not yet clear what, if any, impact the new framework will have on the setting of premiums.

Topic	Comments	OSFI Response
Credit Score Updating	OSFI should consider deferring updating of credit scores until there is more information to calibrate requirements. Updating credit scores introduces volatility and pro-cyclicality.	Recognizing that the mortgage insurers may still need some time to put the appropriate processes in place and to become comfortable with the potential volatility associated with updating credit scores, OSFI has decided that, as a temporary measure, the mortgage insurers would do a one-time update of credit scores similar to the one-time update of property values.
Operational Risk	OSFI should develop a separate capital test for operational risk for mortgage insurers as part of the development of a separate guideline for mortgage insurers. The current operational risk formula does not appropriately capture unique operational risks of mortgage insurers.	The long-term plan is to have a separate capital guideline for mortgage insurers that would include a chapter on operational risk requirements. OSFI will consult with the industry and other stakeholders during its development.
Supplementary Capital Requirement Indicator (SCRI)	In addition to the Teranet House Price Index (HPI), consideration should be given to using the Brookfield HPI and MLS HPI when determining the SCRI.	OSFI is open to using more than one house price index, provided that the index is based on a sound methodology and has sufficient history to enable statistically meaningful threshold values to be determined. In the calculation of the SCRI, OSFI considered a number of methodologically-sound indexes in the calculation of the SCRI but ultimately decided to use the Teranet index because of its longer history (1990-present).
	The SCRI should be calculated using more localized neighbourhood and property style data.	Consistent with the response to the previous comment, any indexes used to calculate the SCRI should have sufficient history to enable statistically meaningful threshold values to be determined. Since this is a standard framework, OSFI is aiming to achieve a balance between simplicity and granularity.
	A regional income measure should be used to calculate the SCRI and the SCRI should reflect income increases observed in Calgary and Edmonton.	The income measure is designed to scale house price values so that threshold values do not need to be continuously updated to reflect normal house price appreciation. Consideration was given to using city specific income data; however, given the paucity of reliable and credible city-specific income data that is available on a timely basis, it was determined that use of a national income measure was a more practical alternative. The use of a national income measure will also dampen the volatility in the SCRI.