



Guideline Impact Analysis Statement

Guideline - Mortgage Insurer Capital Adequacy Test

Date: August 2018

I. Background

In January 2017, OSFI implemented a new regulatory capital framework for mortgage insurance. The new framework is described in the January 1, 2017 Advisory *Capital Requirements for Federally Regulated Mortgage Insurers* (Advisory). This Advisory, together with the relevant portions of the Guideline *Minimum Capital Test for Federally Regulated Property and Casualty Insurance Companies* (MCT Guideline) defines the framework within which OSFI assesses whether a mortgage insurance company maintains adequate capital.

II. Problem Identification

- OSFI developed the MCT Guideline for companies that write property and casualty (P&C) insurance. Although mortgage insurers are legally P&C insurance companies, the coverage they provide is quite different from other P&C insurers. Defining the regulatory capital framework for mortgage insurers using two documents – the January 1, 2017 Advisory and portions of the MCT Guideline – rather than one creates challenges for the companies as well as other stakeholders.
- Effective January 1, 2019, the new International Accounting Standard on lease accounting (IFRS 16) comes into force. Among other things, IFRS 16 will require previously off-balance sheet operating leases to be included on the balance sheet. An adjustment to the mortgage insurance guideline is required to account for the lease liabilities and related assets.
- OSFI is concurrently updating Guideline B-5 – *Asset Securitization*. As a result, capital requirements for mortgage insurers, factors and other adjustments to the mortgage insurance guideline are required.

III. Objective

Given the fundamental differences in the business model and capital requirements of mortgage insurance companies as compared to other property and casualty insurance companies, OSFI believes it appropriate to create a single document that incorporates all elements of the regulatory capital framework for mortgage insurers. Having a separate guideline will also allow OSFI to tailor the capital guideline to mortgage insurers going forward.



In addition, including guidance with respect to upcoming implementation of IFRS 16 and changes to Guideline B-5 – *Asset Securitization* will ensure that the mortgage insurance guideline will be effective and reflective of the developments in the mortgage insurance industry.

IV. Recommendation

OSFI recommends creating a separate capital guideline entitled *Mortgage Insurer Capital Adequacy Test* for mortgage insurers. The new guideline should amalgamate the January 1, 2017 Advisory and the relevant chapters of the 2018 MCT Guideline, with references to P&C insurance, P&C insurers and foreign branches removed.

Based on consultations with the mortgage insurers, OSFI also recommends streamlining the requirements for single-family residential mortgages as follows:

- Base the requirements on borrower credit scores at origination and remove references to credit score updating.
- Increase the requirements uniformly by 5% to allow for deterioration in borrower credit scores after origination.
- Simplify the transition arrangements.

In addition, in preparation for IFRS 16 implementation and changes to Guideline B-5 – *Asset Securitization*, the guideline will:

- Introduce credit risk capital charges to right-of-use assets resulting from the implementation of IFRS 16; and
- Update the credit risk factors for securitized assets and transfer the updated risk factors from Guideline B-5 – *Asset Securitization* to the mortgage insurance guideline.

It is recommended that the guideline *Mortgage Insurer Capital Adequacy Test* be effective in 2019.

V. Implementation

The new capital guideline will come into effect on January 1, 2019. OSFI will monitor the effectiveness of the new guideline and make any necessary modifications when the guideline is next updated in 2021.