Residential Mortgage Underwriting Practices and Procedures Guideline (B-20)

Sound Mortgage Underwriting Contributes to Financial Stability

The safety and stability of federally regulated financial institutions is fundamental to the ongoing health of Canada's financial system and its economy. OSFI contributes to this stability by fulfilling its mandate to protect the interests of depositors and other creditors of financial institutions. It does this by setting standards that improve banks' resilience, both under normal conditions and in the event of a financial downturn.

Lenders subject to OSFI supervision hold nearly 80 per cent of all residential mortgages issued in Canada, and residential mortgage loans account for almost 30 per cent of the total assets held by these lenders. Sound mortgage underwriting practices reduce risks to the financial system, and to Canadians who entrust their savings to Canada's financial institutions.

Sound mortgage underwriting practices require lenders to assess a borrower's ability to pay their loan under a variety of conditions. A lender should consider potential changes to a borrower's income and expenses, as well as changes to the market environment including the valuation of the property that is being mortgaged.

History of the B-20 Guideline

In 2012, OSFI introduced its Residential Mortgage Underwriting Practices and Procedures Guideline (Guideline B-20) to set out expectations for strong residential mortgage underwriting for federally regulated lenders. The original guideline was mostly principles-based and included an expectation that lenders would stress test borrowers for adverse conditions.

In 2016, OSFI reminded lenders of its underwriting expectations in the form of a public letter. When OSFI continued to see examples of relaxed mortgage underwriting at some lenders, it issued an update to B-20 in 2017 that came into effect in January 2018.

The updated B-20 clarified and strengthened expectations to address what OSFI saw as increasing risks in an environment of historically low interest rates, high levels of consumer debt and housing imbalances.

The revised Guideline B-20 includes:

- measures requiring financial institutions to apply greater rigor when assessing a borrower's ability to repay their mortgage loans, including when verifying a borrower's employment status and income history
- a revised minimum qualifying rate (stress test) that requires lenders to confirm borrowers would be able to continue repaying their mortgage loans if faced with a sudden change to their circumstances (income loss, increased interest rates, additional expenses, etc.). The minimum qualifying rate is the greater of the contractual mortgage rate plus two percentage points, or the five-year benchmark rate published by the Bank of Canada
- a requirement for lenders to place more scrutiny on property valuations, establish dynamic loan-to-value limits that reflect the risk of specific properties and markets, and update these limits and practices as housing markets and the economic environment evolve

Mortgage Renewals

The application of B-20 to mortgage renewals has remained consistent since the introduction of the guideline in 2012. When a mortgage renews, the existing lender typically does not re-underwrite the loan as long as the borrower is current with their payments. As the lender is also expected to periodically update its risk analysis throughout the life of the loan, OSFI sees this as a reasonable practice and does not require the re-underwriting of existing mortgages when they come up for renewal.

If a borrower decides to change lenders, the new lender must act responsibly by following their own established underwriting standards. Business models and risk tolerances are different across lenders; it is not responsible for lenders to rely on the past underwriting standards of another lender.

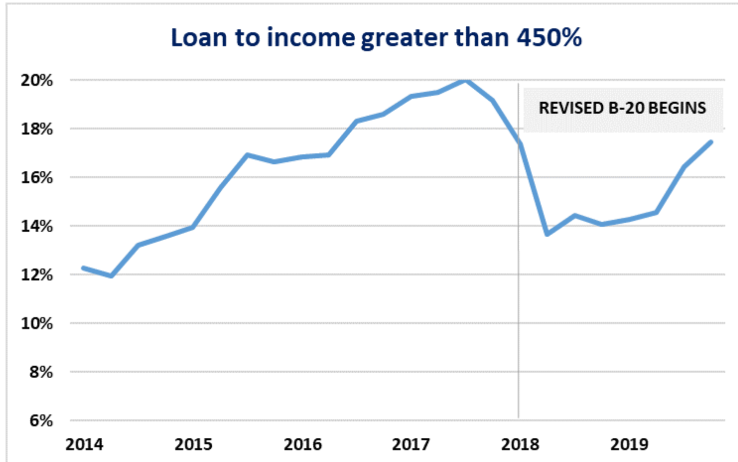
B-20 Impact on Uninsured Mortgages

The following data represents uninsured mortgages from the top 19 federally regulated mortgage lenders. These lenders hold more than 95 per cent of all mortgages subject to OSFI regulation and supervision. Charts 1-3 below include 2019 Q4 data from October and November. Updates will be made once December 2019 data becomes available.

Mortgage underwriting quality warrants attention:

Since the B-20 revisions were put in place, lenders are approving fewer mortgages for the most highly indebted or over-leveraged borrowers.

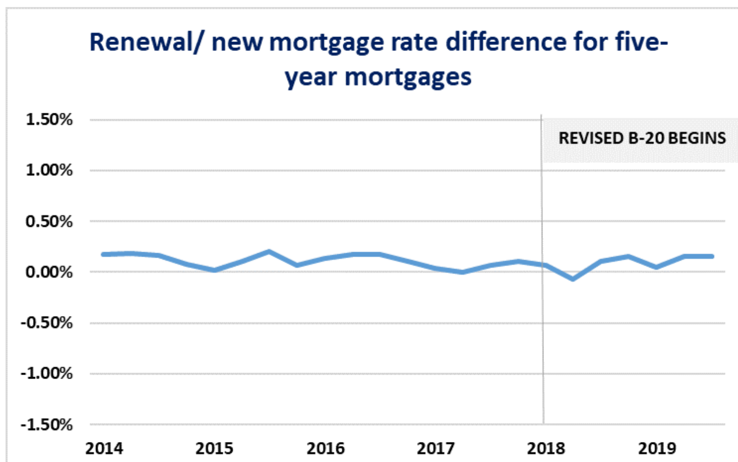
- The proportion of new uninsured mortgage loans that exceed 450 per cent of a borrower's income has declined, from a peak of 20 per cent.
- However, OSFI has recently observed an uptick in mortgage approvals for highly indebted borrowers, seeing a rise from 14 per cent to 17.5 per cent in 2019. This increase has been partially supported by a decline in mortgage rates. OSFI will monitor this area closely. (See Chart 1)



Rates at renewal are stable:

Concerns have been raised that the stress test could limit a borrower's ability to obtain competitive rates at renewal.

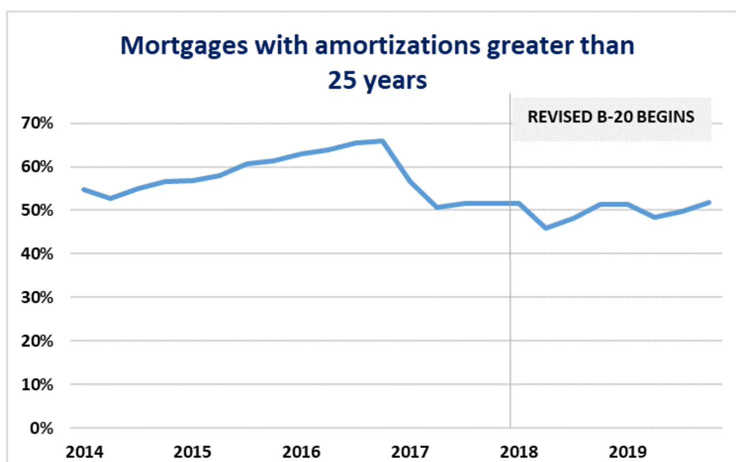
- OSFI indicated it would be monitoring this closely, and data from OSFI regulated lenders shows that following the introduction of the revised guideline, the difference between renewal and new mortgage rates for uninsured five-year fixed and variable rate mortgages has remained largely unchanged. (See Chart 2)
- The Financial Consumer Agency of Canada has some helpful tips for borrowers to consider when renewing a mortgage.



Amortization periods not extending:

Insured mortgages have a maximum amortization period of 25 years, while uninsured mortgages subject to B-20 can be paid over a longer period.

- Uninsured mortgage borrowers do not appear to be extending amortization periods to pass the stress test requirement. (See Chart 3)



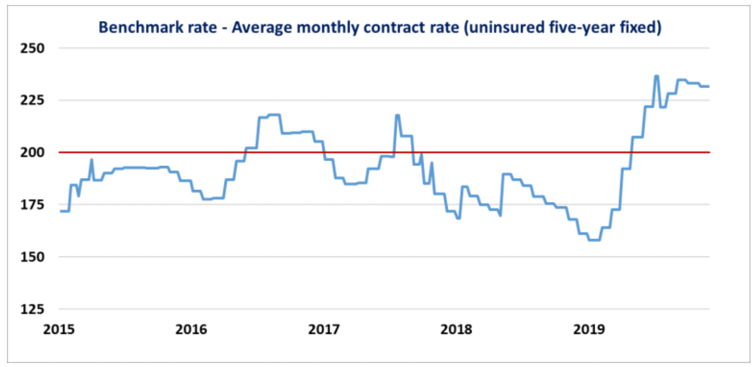
The revisions to B-20 are working, strengthening mortgage underwriting across Canada and improving the resilience of the Canadian financial system to future shocks. OSFI will continue to monitor lender practices, particularly in the area of income verification and will be proactive with lenders when it identifies areas requiring attention.

Reviewing the Responsiveness of the Benchmark Rate

Under B-20, the minimum qualifying rate for uninsured mortgages is calculated using the greater of the contractual mortgage rate plus 200 basis points (2 per cent), or the five-year benchmark rate published by the Bank of Canada. OSFI is confident that the contract rate plus 200 basis points is a reasonable measure to qualify a borrower. This will remain a key part of OSFI's guideline B-20.

The benchmark rate is based on the posted rates from the big six banks in Canada, and is intended to serve as a responsive floor for the qualifying rate.

- For many years, the difference between the five-year posted rate and the average contract rates was about 200 basis points, which provided a healthy buffer.
- Recently, the difference between the two has widened, making the benchmark less responsive to market changes than when it was first proposed. (See Chart 4)
- OSFI is reviewing this specific aspect of the qualifying rate.



Associated Links

[Guideline B-20: Residential Mortgage Underwriting Practices and Procedures]

[Speech: Sound Mortgage Underwriting: Foundation for Stability]