

OSFI PUBLISHES LETTER ON PLANS TO UPDATE CAPITAL REQUIREMENTS FOR RESIDENTIAL MORTGAGES

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On December 11, 2015 the Office of the Superintendent of Financial Institutions Canada (OSFI) released a letter notifying stakeholders that it is planning to update the regulatory capital requirements for residential mortgages and home equity lines of credit. It is one component of the broader attempt on the part of the government to mitigate risks associated with rapid rise in house prices and high ratio of debt to income borrowing. The letter was released on the same day that Minister of Finance, Bill Morneau, announced rules that increase the minimum down payment for newly insured mortgages from 5% to 10% on the portion of house prices above \$500,000 and Canada Mortgage and Housing Corporation (CMHC) announced changes to its securitization programs.

The regulatory capital requirements are in place to mitigate the risk that federally regulated financial institutions face in loss scenarios. Currently, in recognition of the government backstop on mortgages, federally regulated deposit-taking institutions are subject to very low capital holding requirements on mortgages.

The planned changes will affect the deposit-taking institutions using internal models for mortgage default risk, which include Bank of Montreal, Bank of Nova Scotia, Canadian Imperial Bank of Commerce, HSBC Canada, National Bank of Canada, Royal Bank of Canada, and Toronto-Dominion Bank. For these banks, OSFI plans to implement a risk-sensitive floor for losses in the event of default that will be tied to increases in local property prices and/or to house prices that are high relative to borrower income.

The planned changes will also affect private mortgage insurers, Canada Guaranty Mortgage Insurance Company and Genworth Financial Mortgage Insurance Company of Canada, using standardized capital requirements. For these insurers, a new standardized approach that updates the capital requirements for mortgage guarantee insurance risk will be introduced. Both planned changes are devised to provide increased protection to depositors, policyholders, and unsecured creditors.

OSFI has not yet released any guidelines in this respect, but expects to have final rules in place no later than 2017. Prior to any such changes and keeping with usual practice, OSFI will engage the federally regulated financial institutions and other stakeholders in a directed consultation followed by a broader public

consultation in 2016.

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A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

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