

OSFI PUBLISHES LETTER REGARDING THE TIGHTENING OF ITS SUPERVISORY EXPECTATIONS FOR MORTGAGE UNDERWRITING

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On July 7, 2016, the Office of the Superintendent of Financial Institutions ("**OSFI**") released a letter advising federally regulated financial institutions ("**FRFIs**") that it is tightening its supervisory expectations for residential mortgage underwriting and that it will be reviewing *Guideline B-20 - Residential Mortgage Underwriting Practices and Procedures* ("**Guideline B-20**") to ensure that it is aligned with prudent industry practice and Canadian housing market realities.

Such realities include rapidly increasing housing prices (especially in Toronto and Vancouver), high Canadian household debt and low interest rates; risk factors which have been identified by the Bank of Canada as escalating in prevalence. OSFI's increased scrutiny is a precautionary measure to protect FRFIs from financial risks such as loan losses through mortgage defaults, and decreased value of real estate pledged as collateral in mortgage loans. The July letter builds upon OSFI's December 11, 2015 letter which described, among other things, OSFI's intent to study and update the regulatory capital requirements for residential mortgages and home equity lines of credit (as described in our previous [bulletin](#)).

OSFI has identified five areas that will be particularly scrutinized: (i) income verification (especially foreign income), (ii) non-conforming loans, (iii) debt service ratios, (iv) appraisals and loan-to-value (LTV) ratio calculations, and (v) institutional risk appetite.

In addition, and consistent with its plans to update regulatory capital requirements for residential mortgages, OSFI aims to implement various capital policy initiatives by November 2016 and January 2017 for banks and mortgage insurers, respectively, which will better equip FRFIs to endure and manage potential losses stemming from residential mortgage underwriting and mortgage insurance operations. Such initiatives include a risk sensitive floor and a new regulatory capital framework being developed for federally regulated mortgage insurers. OSFI is also evaluating a proposal by the Basel Committee on Banking Supervision (BCBS) aimed at increasing the sensitivity of standardized credit risk approaches for loans secured by residential real estate. There is no set target date for the completion of this review.

In addition to increased supervisory oversight and updating capital policy initiatives, OSFI reinforced the need

for prudent residential mortgage underwriting practices based on the principles of Guideline B-20 and *Guideline B-21- Residential Mortgage Insurance Underwriting Practices and Procedures*.

The review and tightening of the underwriting practices of federally regulated lenders will likely result in a decrease in the volume of mortgages and in the size of the mortgages being approved. It remains to be seen whether these mortgages will be picked up by provincially regulated lenders such as credit unions, or if such lenders will choose to similarly follow the guidance published by OSFI.

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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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