Ontario

Deposit Insurance
Corporation of Ontario

Société ontarienne
d'assurance-dépôts

LENDING ADVISORY #5 **NOVEMBER 2017**

MORTGAGE LENDING PRACTICES

Background

In October 2017, OSFI introduced revisions to their guideline on Residential Mortgage Underwriting Practices and Procedures (B-20) that include the requirement for the stress testing of uninsured mortgages and introduce a restriction over co-lending or bundling of loans.

1. Mortgage Stress Testing

OSFI's revised B-20 guideline requires all mortgage loans (insured and uninsured) be stress tested to ensure that borrowers can still service their mortgage at a higher interest rate than the contractual mortgage rate. The additional stress testing should also consider the risk associated with the potential loss of income from a supporting spouse or co-borrower.

- For insured mortgages: the Government of Canada's mortgage insurance guarantee framework requires, for all variable interest rate mortgages regardless of the term, and fixed rate mortgages with a term less than the standard five-year term, that lenders use the greater of the contractual mortgage rate or the five-year benchmark rate published by the Bank of Canada.
- For uninsured mortgages: the minimum qualifying rate for uninsured mortgages is the greater of the five-year benchmark rate published by the Bank of Canada or the contractual mortgage rate plus 2%.

2. Restrictions on Co-Lending and Bundled Mortgages

The revised B-20 also restricts co-lending arrangements (or bundling of loans) designed to circumvent maximum loan to value (LTV) requirements for OSFI-regulated lenders. In practice, a regulated lender (primary lender) can arrange for a secondary unregulated lender to provide the portion of the loan greater than 80% LTV (65% for sub-prime borrowers), thus circumventing the requirement for Government insurance.

Implications to Credit Unions

With these heightened restrictions on OSFI-regulated lenders and ever-increasing house prices in Ontario, DICO is cautioning credit unions concerning the potential risk of a migration of riskier borrowers from banks to the credit union sector.

DICO expects credit unions to ensure their risk of exposure to borrowers that may become unable to service their debt obligations under stressed conditions is appropriately managed by implementing prudent policies and practices that address the quality, stability and reliability of the borrowers and co-borrower's income and any factors that may adversely affect it, such as a rise in interest rates.

Credit union boards should be aware of any unique exposure their credit union may have to the residential mortgage market in their geographic location and ensure that stress testing of correlated stress factors is conducted on the residential mortgage portfolio to assess the impact of a housing market correction and higher interest rates.

DICO expects credit unions not to arrange a mortgage or combination of a mortgage and other lending products (secured by the same property) in any form that circumvents the credit union's maximum LTV ratio or other limits in its residential mortgage underwriting policy, or any requirements established by law.

DICO is currently reviewing its lending guidance as the result of the changes to the Credit Unions and Caisses Populaires Act. As part of this review, DICO will also assess the applicability of some of the elements of OSFI's B-20 guideline as it updates existing lending guidance to reflect prudent residential mortgage underwriting practices in a changing marketplace.