Residential Mortgage Underwriting Practices and Procedures

Introduction

This Guidance is intended to assist Alberta credit unions in establishing policies for sound residential mortgage (RML) underwriting practices, in light of recent requirements by the Office of the Superintendent of Financial Institutions (OSFI) for federally regulated financial institutions. This includes factors that the credit union board of directors and senior management should consider to ensure that policies are implemented effectively and reflect the credit union Board risk appetite, business operations and appropriate controls. For example, securitization of credit union uninsured mortgages may be compromised if underwriting practices do not follow mortgage insurer requirements for portfolio insurance. This could remove a significant source of liquidity available under the CMHC NHA Canada Mortgage Bond program.

Background

April 2012 - The Financial Stability Board released their international Principles for Sound Residential Mortgage Underwriting Practices.

June 2012 - OSFI published their Residential Mortgage Underwriting Practices and Procedures (B-20) guideline outlining five main principles for prudent mortgage underwriting and/or acquisition. These principles are included in the current Corporation Credit Risk Management Model Policy.

July 2016 - OSFI revised their B-20 Guideline establishing an upper limit of 65 percent Loan-to-Value (LTV) for Home Equity Lines of Credit (HELOC) and uninsured loans considered to be "non-conforming". OSFI stated that mortgage lenders should establish clear limits for their risk appetite regarding aggregate uninsured non-conforming mortgages.

October 2016 – Federal Department of Finance required insured home buyers to qualify at the greater of their contract mortgage rate or the Bank of Canada five-year fixed posted rate.

Effective January 1, 2018 - OSFI revised their B-20 guideline, requiring the minimum qualifying rate for uninsured mortgages to be the greater of the five-year benchmark rate published by the Bank of Canada or the contractual mortgage rate +2%. Mortgage lenders are also required to enhance their LTV measurement and limits so they will be dynamic and responsive to risk.

The Corporation included the five principles for prudent mortgage underwriting in the Credit Risk Management Model Policy V2. The model policy also suggests establishing standard and exception loan-to-values for HELOCs and uninsured non-conforming mortgages and stress testing the Gross Debt Service Ratio for uninsured mortgage applications at the greater of the credit union or Bank of Canada five-year rate. The

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credit union five-year rate would change to the contract rate plus 200 BPS under this guidance. The Corporation is issuing this new guidance to formalize the RML underwriting criteria contained within the Credit Risk Management Model Policy and align the underwriting criteria with the recent OSFI standard, as appropriate to Alberta credit unions.

Alberta Credit Union Enhanced RML and HELOC Underwriting Criteria

- Income qualification for uninsured mortgage originations will be stressed, based on the greater of the contractual rate plus 200 BPS or the Bank of Canada 5-year benchmark mortgage rate. Gross and Total Debt Service Ratios should be conservative measures to establish member affordability and support credit union prudent credit risk management. The qualifying ratios in the credit union Residential Mortgage Underwriting Policy and Lending Guidelines are to include Gross Debt Service and Total Debt Service thresholds, supported by appropriate criteria to reflect the strength of the mortgage application. Lower beacon scores and exceptions should consider increased pricing and reduced Loan-to-Value.
- LTV measurement will be considered dynamic and responsive to risk if the LTV is adjusted based for higher dollar value residences. Many credit unions have a "sliding scale" LTV that reduces as the value of the property exceeds certain threshold values. Some credit unions also adjust the LTV based on location of the property. Other dynamic methods of adjusting the LTV to market conditions may be considered.
- The standard LTV for HELOCs should be no more than 65%. Financing over 65% to a maximum 80%, should be amortized over a maximum 25-years.
- The standard LTV for uninsured non-conforming mortgages should be no more than 65%.

  Non-Conforming Mortgages are a subset of uninsured mortgage loans and are broadly defined as having higher-risk attributes or deficiencies, relative to other mortgages. Non-conforming Mortgages can include non-income qualifying, loans to individuals with low credit scores or high debt serviceability ratios, mortgages where attributes of the property cause the loan to carry elevated credit risk (e.g., illiquid properties) or any loan that has clear deficiencies relative to a conforming uninsured residential mortgage. Credit union policies should include a comprehensive risk-based definition for uninsured non-conforming mortgages. The definition should encompass each of the types of loans identified in the guideline and should establish specific threshold limits which, when exceeded, results in designating a mortgage as non-conforming.

The credit union, within their designated lending limit, may approve exceptions, if mitigated or warranted for:

- Stressed debt service ratios that exceed mortgage lending guidelines for uninsured mortgages.
- Loan-to-Value greater than 65% and less than 80% for Home Equity Lines of Credit and non-conforming mortgages.

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Exception(s) must be documented within the mortgage application, supported by mitigating factors and approved by the appropriate authority level. The credit union should track exceptions and provide aggregate reporting to the Board or Risk Committee at least annually.

Implementation

This guidance is effective May 1, 2018 for new mortgage and HELOC originations. Existing commitments, including undrawn facilities, may be grandfathered under existing RML underwriting criteria.

Residential mortgage applications forwarded to the Corporation for approval are adjudicated based on the Corporation's underwriting criteria. The underwriting quality of credit union approved residential mortgages and Home Equity Lines of Credit will continue to be assessed through the Corporation's Loan Transaction Review (LTR) program and the monitoring process, including Credit Risk Assessments and On-Site Verifications.

Prudent RML underwriting principles, practices and procedures are included in the Corporation Credit Risk Management Model Policy and Corporation RML lending guidelines, which will be amended to include the above enhanced underwriting criteria, concurrently with the release of this guidance.

Should you have any questions or comments, we encourage you to contact your Manager, Regulation & Credit Risk Assessment, the Assistant Vice President Regulation & Credit Risk Assessment or the Executive Vice President, Regulation & Risk Assessment.

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