



## Speaking Points on Recent Changes to Mortgage Insurance and Qualifications

*The following document may be useful when discussing the impact of the recent federal government announcement to change mortgage insurance and qualifications. This is intended to help facilitate a discussion with government officials or Members of Parliament. If you have specific examples of clients who you know will be impacted, it may be helpful to provide those personal examples in your discussions. It is very important to remember that a respectful tone and conversation will have the greatest impact on decision makers.*

### **Background**

Federal Finance Minister Morneau outlined mortgage insurance and qualification changes.

1. All insured mortgages with a down payment of less than 20% will now need to qualify at the greater of either the Bank of Canada benchmark rate (4.64%) or the contract rate offered on their commitment. This change came into effect on October 17, 2016. This stress test will be expanded to all insured mortgages, regardless of down payment size, requiring the borrower to qualify at the greater of the Bank of Canada benchmark rate (4.64%) or the contract rate offered on their commitment effective November 30, 2017.
2. Portfolio ('bulk') insurance must now meet the same criteria as those that are high ratio insured. This change is also scheduled to come into effect on November 30. This means that amortizations greater than 25 years, rental and investment properties, refinances, and homes with values greater than \$1M can no longer be portfolio-insured.
3. Capital gains exemptions on principal residences will apply only to residents of Canada.
4. In addition, there is further discussion about 'sharing in risk' that is currently borne in large part by the three mortgage insurers (and in large part back stopped by the Federal Government). While high ratio customers and portfolio insurance funders pay for this risk, there is discussion about sharing in the cost of losses beyond just the mortgage insurers. This in and of itself could have significant implications. We will continue to monitor any discussion around this as well.

### **Setting the Stage**

Frame the mortgage broker channel for the MP or government official you are speaking with.

- The mortgage broker channel originates approximately 33% of all mortgages in Canada, and approximately 50% of mortgages for first-time buyers. This represents approximately \$80 billion
- We are an incredibly important segment of the economy and help maintain a healthy and competitive marketplace
- These changes were announced with no warning to our industry and almost no consultation
- State that we have concerns about the potential impacts and unintended consequences of these changes for Canadian consumers.

## ***How will this impact my customers?***

Highlight the three numbered points in your conversations:

- 1. A large contingent of borrowers may see their overall purchasing power artificially reduced by upwards of 20%.**

According to StatsCan, the average Canadian family earned \$78,870 in 2014. Let's use this as the basis of a hypothetical mortgage qualification, along with an estimated property tax bill of \$2,000 annually and heating costs of \$200 a month. A common current market rate for a fixed 5 year mortgage is 2.29%. Lower rates are available but we'll use this for the example. With good credit history, the average Canadian family can afford to purchase a property worth \$403,109 with a 5% down payment. Requiring the family to qualify at the benchmark rate of 4.64%, they can afford to purchase a property worth \$314,264. This is a significant reduction in purchasing power and may force many middle class families to find housing further from their places of work and family. **An additional 2% interest rate "stress test" sounds small, but in application equates to a 20% reduction in purchasing power.**<sup>1</sup>

- 2. These changes may increase the mortgage rates offered by many of the lenders who sell through mortgage brokers, costing Canadians thousands more dollars through the lifespan of their mortgage**

Many of the lenders currently offering mortgages through brokers depend on the insurance to securitize their debt; bulk insurance is required to meet CMHC's Canada Mortgage Bond securitization guidelines. Without this insurance, the lenders would have to find more expensive funding alternatives, thereby increasing rates that consumers pay and decreasing choice.

- 3. There may be a reduction in the number of lenders in the Canadian marketplace, leading to less competition and mortgage availability**

Since the large banks are sufficiently capitalized (have enough assets) to issue loans directly and retain them on their books, they have more access to uninsured funding. They can therefore continue to issue mortgages at lower rates hurting the competitiveness of the smaller lenders. The smaller lenders are therefore under threat and some may fold or consolidate with others. In either case, the result is less choice for Canadian consumers. Additionally, the same banks are trusted to set the mortgage qualification rate.

## ***How will this impact the economy?***

- 1. House prices may fall as a result of these changes**

Toronto and Vancouver have received much attention in the press, but the rest of Canada is in a considerably different economic climate. House prices have seen mild appreciation or in some areas mild depreciation over the last few years. Depressing middle class Canadians' purchasing power will have an impact of housing affordability that will see house prices fall. A reduction in the real value of their largest asset will also have psychological "wealth effect" results, causing more people to spend less and save more, thereby slowing many Canadian economies further.

The risk the government is trying to mitigate, that Canadians find themselves with a larger mortgage than property value after a price correction, could actually become a self-fulfilling prophecy following the implementation of these changes.

---

<sup>1</sup>Numbers generated using the mortgage calculator found on Scotiabank's website  
<http://cgi.scotiabank.com/mortgage/afford/en/index.html>

## Suggestions

1. If the government is intent on applying a stress test for insured mortgages, use a mechanism to set stress test published rates that are not dependent on the big six banks

The current mechanism for setting the Bank of Canada posted five-year rate is to use the mode (most frequently occurring) five-year posted rate of the Big Six Banks. This rate is somewhat arbitrary as it is rarely, if ever, used by the banks to actually issue a mortgage. Relying on the banks to set and move these rates essentially places regulatory authority in their hands. The Bank of Canada should consider setting benchmark rates based on other market criteria, e.g., current market rates for 5 or 10 year bonds with adjustments based upon a mortgagees risk.

2. Tier the differential between actual market rates and the stress test rate according to the term of the mortgage

On the same subject: The risk that a consumer will not be able to afford their debt level in the event of an interest rate increase automatically reduces as the term of a mortgage gets longer. A consumer with a five-year mortgage will not pay down as much principal by the end of the mortgage term as a customer in a seven-year mortgage. Because the seven-year mortgage term customer will have a higher percentage of equity in their home, and therefore less relative debt at the end of the term, the risk of a mortgage default is lower. As such, consider setting benchmark rates that reflect the possible impact to a consumer of and interest rate spike while considering the renewing mortgagee's terms and earned equity to debt ratio.

Example –

Term	1 Year	3 Year	5 year	7 Year	10 Year
Actual Rate	2.29%	2.39%	2.59%	3.44%	3.84%
Stress Test Premium	2.00%	1.50%	1.00%	0.50%	0.00%
<b>Qualifying Rate</b>	<b>4.29%</b>	<b>3.89%</b>	<b>3.59%</b>	<b>3.94%</b>	<b>3.84%</b>
<b>Debt Reduction / Equity Accumulation</b>					
% Paid Down / End of Term	3.00%	9.11%	15.21%	20.04%	29.14%

3. These rules are introduced only for government backed insured mortgages. For unity and to ensure the same protections for all Canadians, we recommend OSFI set similar standards for non-insured mortgages issued by lenders.

By virtue of these requirements being set as eligibility guidelines for insured mortgages, larger lenders may continue to issue loans to individuals with a 20% or greater equity in their homes without applying the stress test criteria by virtue of there being no need to insure the loan. Without OSFI also introducing similar requirements, larger lenders will find themselves with a competitive advantage over smaller lenders, an outcome that contravenes the intent of the Canada Mortgage Bond system, as described directly on CHMC's website.

*In 2001, CMHC introduced Canada Mortgage Bonds (CMB), an attractive, high-quality and simple investment option that provides reliable and cost-effective mortgage funding for lenders. Small lenders in particular, which have limited funding channels, have benefitted from the ability to access this Program. This allows them to compete more effectively with larger financial institutions. Competition among a wide range of mortgage lenders supports innovation and leads to more and better choices for Canadian borrowers.*