



**Credit Union
Central of Canada**

August 21, 2008

Jeremy Rudin
General Director
FSP - Assistant Deputy Minister's Office
Financial Sector Policy Branch
Finance Canada
Ottawa,
K1A 0G5

Dear Mr. Rudin,

RE: REVISION OF MORTGAGE INSURANCE GUARANTEE PARAMETERS

This letter is in response to Finance Canada's recent proposals to adjust the program parameters associated with the Federal Government's mortgage insurance guarantee. As you will recall, these proposals were discussed in detail with representatives of the credit union system during two recent conference calls. Credit Union Central of Canada (Canadian Central) appreciates the opportunity to comment further on the proposed changes.

Canadian Central has canvassed credit union system representatives on our National Lenders Committee and has obtained considerable feedback, both positive and critical, from Committee members. This letter distills these comments and concerns.

In general, credit union system representatives consider it prudent for the Federal Government to be acting now and reviewing the scope and extent of the mortgage insurance guarantee. In light of the significant deterioration in the housing market in the United States, United Kingdom, and parts of continental Europe it is also understandable that the Federal Government would seek to adjust aspects of the mortgage insurance parameters that may inadvertently give rise to excessive risk-taking and expose the Federal Government to potentially significant liabilities in the future.

Nonetheless, Committee members consider some of the proposed adjustments to the mortgage insurance program parameters to be excessive in that they will significantly reduce mortgage financing available to borrowers that have not been shown to pose a substantial risk of default. Furthermore, some of the proposed changes to the program parameters will present substantial difficulties for credit unions in terms of complying with the new requirements. Finally, Committee members are concerned that, without greater clarity in relation to some of the proposed changes, the proposed program parameters may increase the risk of inadvertent noncompliance with the changed parameters. The following paragraphs will discuss these issues in turn.

First of all, Canadian Central considers the proposed 620 Beacon Score floor to be too restrictive and does not seem to have been chosen based on evidence showing that, as scores start to fall below 620, the risk of default rises considerably. In short, the proposed 620 score appears arbitrary.

Furthermore, imposing such a restrictive floor will also significantly impact credit union mortgage lending. Based on two sets of sample data obtained from the credit union system, Canadian Central estimates that, if the proposed 620 floor was in place now, upwards of 15% of our currently approved borrowers would not qualify for mortgage insurance. If these numbers are at all representative of other lenders this would represent a considerable contraction in the availability of mortgage financing in Canada¹. If the Federal Government's intent is to attenuate high risk and possibly speculative elements in the market it would appear that the proposed 620 floor significantly over-shoots the mark particularly in light of recent International Monetary Fund reports that the Canadian housing is not showing any signs of over-valuation or speculation.²

Canadian Central acknowledges that the Federal Government is also proposing to establish a three per cent "exception basket" that would allow a mortgage insurer to insure a high ratio mortgage on an eligible residential property in the absence of a credit score equal to or above 620. The percentage of

¹ Furthermore, this pull back in mortgage finance would be taking place in a context when the Canadian housing market is showing strong signs of a slowdown. For example, the Canada Mortgage and Housing Corporation estimates that housing starts in July 2008 are down 17% from the year before. See Canada Mortgage and Housing Corporation. *Preliminary Housing Start Data* (August 2008). p. 3.

² In fact, the IMF estimates that the Canadian housing market is actually under-valued by approximately 5%. See: International Monetary Fund. *World Economic Outlook*. (April, 2008), p. 113-115. The IMF made this estimate based on two different indicators: the extent to which the increase in house prices in recent years cannot be explained by economic fundamentals, and second, the size of the increase in the residential investment-to-GDP ratio experienced during the past 10 years. In contrast, the same report estimates that the American housing market is over-valued by 12% and the United Kingdom's is over-valued by 25%.

mortgages in the exception basket would be measured at the end of every Quarter. In principal, Canadian Central is supportive of this proposal in that it recognizes the shortcomings associated with establishing the 620 Beacon score for mortgage insurance qualification. However, Canadian Central is of the view that, in practice, it could be quite difficult for credit unions to track their lending relative to the three per cent rule and it is unclear whether the three per cent will be measured in terms of deals approved or in terms of a quarter's advanced.³

Finally, Canadian Central is concerned that some of the proposed parameters – as currently drafted – lack clarity thus opening the way for possible misinterpretation by financial institutions and inadvertent non-compliance. For example, in Section C of the proposed parameters the drafters make liberal use of the phrases such as “reasonable effort” or “reasonable verification” with limited guidance as to how these phrases should be understood.

For example, Section C(1)(g) states that “...the lender or the Mortgage Insurer must have obtained Reasonable Verification of the Value of the Eligible Residential Property on or immediately before the day on which the mortgage loan was approved”⁴. Is Finance Canada suggesting that financial institutions obtain an appraisal of the property or perhaps a tax assessment? In regard to a new purchase, would an “Offer to Purchase” qualify as an assessment of reasonable value? In Section C(3)(h) it states that “...the lender must have reasonably verified the borrowers’ income and employment status...” but does not indicate what constitutes “reasonable” in such a situation. Similarly in Section C(1)(i) it states that “...the lender or Mortgage Insurer must have made a reasonable effort to assess the reasonableness of the stated income of the [self-employed] borrower...” without providing

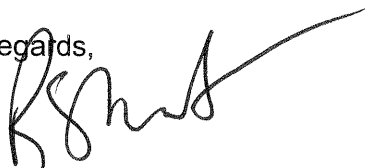
³ Canadian Central understands that Finance Canada is considering the creation of a “carve out’ from the Beacon Score parameters for new immigrants seeking mortgages since many new immigrants do not have a credit history that would generate a Beacon Score. However, as a corollary to this move Finance Canada would also shrink the size of the three per cent exception basket currently being proposed. The proposal to create a mechanism to deal with new immigrants is understandable and will help financial institutions – especially in large urban areas – deal such situations, however, credit unions often serve areas that are not seeing an influx of new immigrants and thus would make little use of the proposed mechanism. However, shrinking the 3% basket would further reduce the mortgage business such credit unions could do.

⁴ Canadian Central also recommends that the wording in this section be revised so that the lender or mortgage insurer would be required to obtain verification of the value “...prior to the loan funding...” as opposed to “... on or immediately before the day on which the mortgage loan was approved.” Currently, it is typical that when a mortgage loan is approved documentation such as income & employment verification and property valuation is not readily available. However, the formal commitment to provide financing is generally contingent upon receipt and verification of such documentation. Our concern is that the current wording suggests that this documentation be available prior to the commitment being offered and this is not practical.

guidance on how to interpret this requirement. Gaining greater clarity in regard to the meaning of such phrases is important so that lenders can have greater certainty that their lending will be covered by the guarantee should it be required. Canadian Central would be pleased to assist Finance Canada and other stakeholders develop shared definitions in regard to such key phrases.

If you have any questions about the issues raised in this letter please contact Rob Martin in our Government Relations Department at 613-238-6747 extension 327 or at rob@coopscanada.coop.

Regards,



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