Key Features of the Canadian Housing Finance System

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Overview of the Canadian mortgage market

- Mortgage interests are not tax deductible
- Mortgage market is national. Largely dominated by domestic lenders, in particular the big banks
- Mortgage loans are recourse loans
- Amortization period: generally 25 years but longer periods more popular over past few years
- Mortgage term: from 6 months to 10 years; most common: 5 years
- Fixed- and variable-rate mortgages
- Other options: pre-payment, portability, blend-and-extend
- On balance-sheet funding of mortgages dominates; but securitization has increased over time
- Sub-prime mortgage lending very limited and relatively conservative

Link to mortgage credit outstanding by lender slide

Mortgage Insurance

- Mortgage insurance compulsory for mortgages with a loan-to-value ratio above a certain percentage (currently 80%)
- High-ratio mortgages insured for their entire life
- Mortgage insurance covers the whole mortgage
- Mortgage insurance premium paid by the borrower upfront
- Insured mortgages benefit from an explicit government guarantee
- Two mortgage insurers in Canada: CMHC (federal agency) and a private insurer that also benefits from an explicit government guarantee
- Eligibility criteria and pricing set by mortgage insurers but the government sets the minimum standards

Securitization

- Rising off-balance sheet funding over the past 2 decades driven by government initiatives: NHA-MBS and CMB programs
- Objective of these programs: improve the supply of low-cost mortgage funding
- NHA-MBS are backed by insured mortgages. NHA-MBS benefit from an explicit government guarantee in case of issuer default
- Non-NHA MBS very limited, especially following the crisis
- Canada Mortgage Bond (CMB). The Canada Housing Trust (CHT) transforms cash flows from newly issued NHA-MBS to sell non-amortizing CMBs to investors. CMHC guarantees the timely payment of CMB interest and principal.

Link to securitization chart

Link to additional background on securitization

Innovations in mortgage market prior to the crisis

- Early-mid 2000s: some innovation in Canadian housing finance
- Subprime/Non-prime mortgage market
  - Small
  - "Conservative" products and underwriting standards
  - Funding largely through securitization
- Innovations in mortgage insurance
  - Expansion of eligible borrowers: self-employed, Alt-A borrowers
  - Product innovation: extension of amortization period (up to 40 years), increased loan-to-value ratios (up to 100%)

Crisis: impact and lessons learned

- Canadian mortgage and housing markets resilient during the crisis
- Impact on subprime lending.
- Adjustments to the mortgage insurance framework by authorities to ensure risk characteristics remain acceptable
  - 2008: max loan-to-value ratio decreased to 95%; max amortization period shortened to 35 years, consistent minimum credit score and loan documentation standards, max debt-service ratio standard
  - 2010: stricter qualification standard, lower max refinancing, 20% down payment for non-owner-occupied properties

Regulation

- Bank Act, Cost of Borrowing Regulations, Interest Act
- Disclosure requirements
- Voluntary codes of conduct: Canadian Bankers Association (CBA) Commitment to Plain Language in Mortgage Documents
- Plain Language – amendment to cost of borrowing regulations (September 2009)
- Financial Consumer Agency of Canada (FCAC) – mandate
  - Ensure that federally regulated financial institutions (FIs) comply with financial consumer protection laws and regulations
  - Monitor FIs' compliance with voluntary codes of conduct
  - Inform consumers about their rights and responsibilities when dealing with FIs
  - Provide timely and objective information and tools to help consumers understand, and shop around for, a variety of financial products and services

Link to regulation background slide

Conclusion

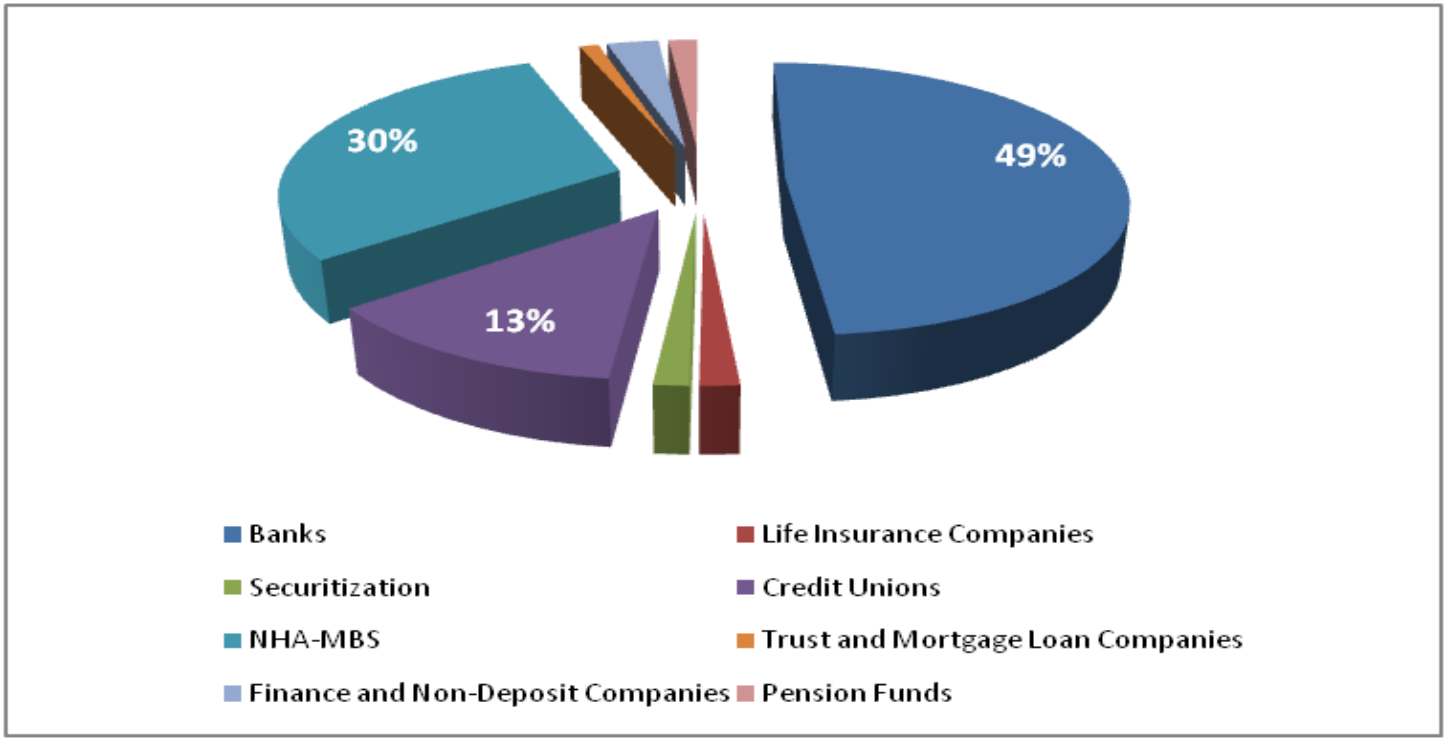
- **The Canadian mortgage and housing markets have been resilient during the crisis**
- **Relatively conservative housing and mortgage policies contributed to this resilience**
- **Canadian authorities have adopted a proactive approach: adjustments to the mortgage insurance framework to ensure risk characteristics remain acceptable**

Link to house price chart

Link to home equity chart

Background slides

Distribution of mortgage credit by type of lender (as of March 2010)



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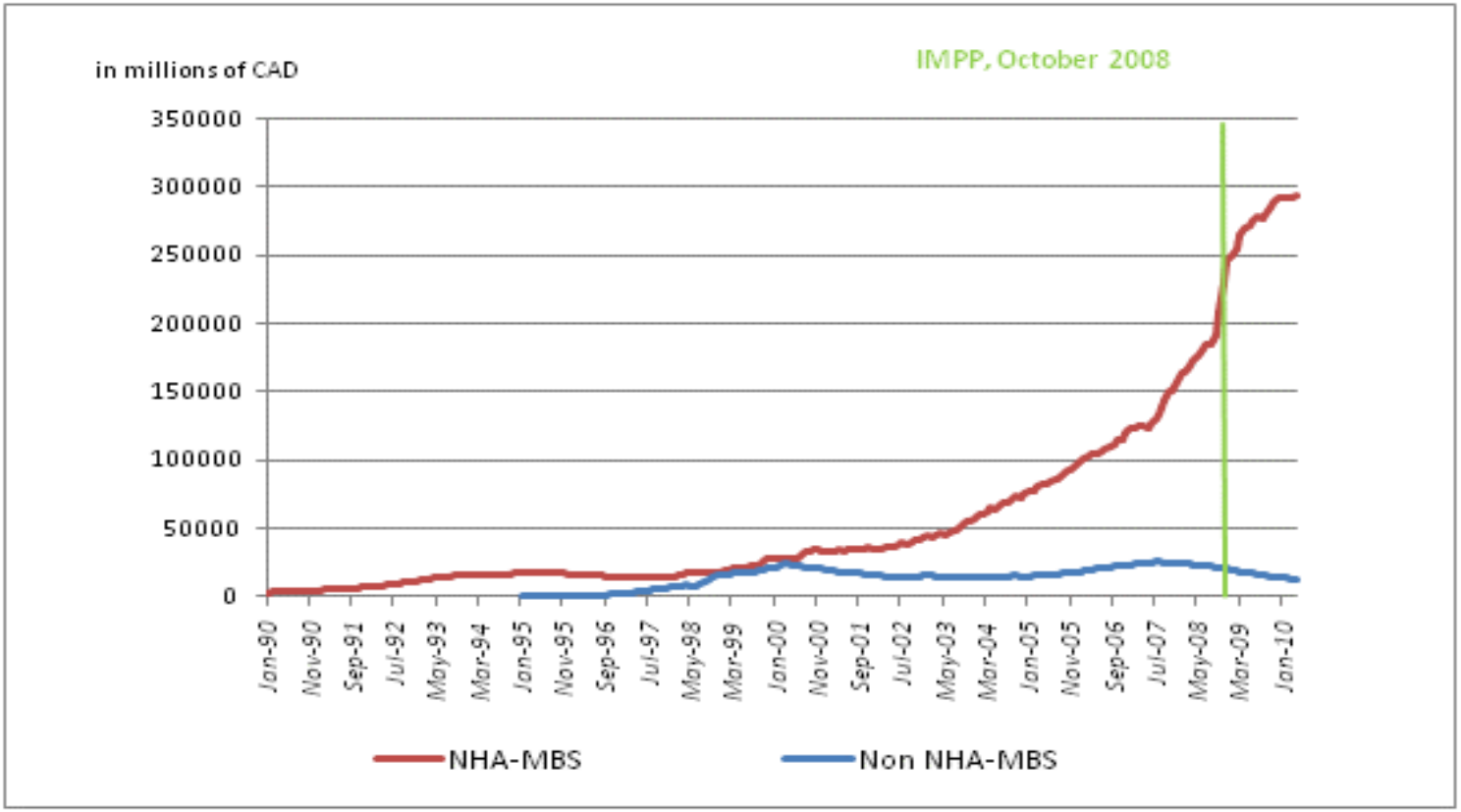
Securitization has increased over the past 2 decades



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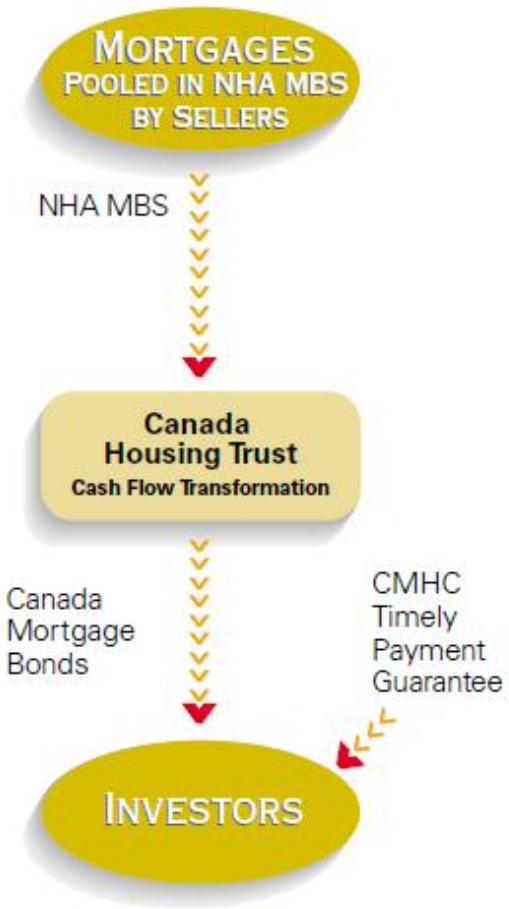
NHA-MBS and CMB programs – background information

- NHA-MBS program introduced in 1987. Objective: promote the development of a secondary mortgage market in Canada, thus improving the supply of low-cost mortgage funding

- CMB program introduced in 2001. Objective: contribute further to the supply of mortgage financing



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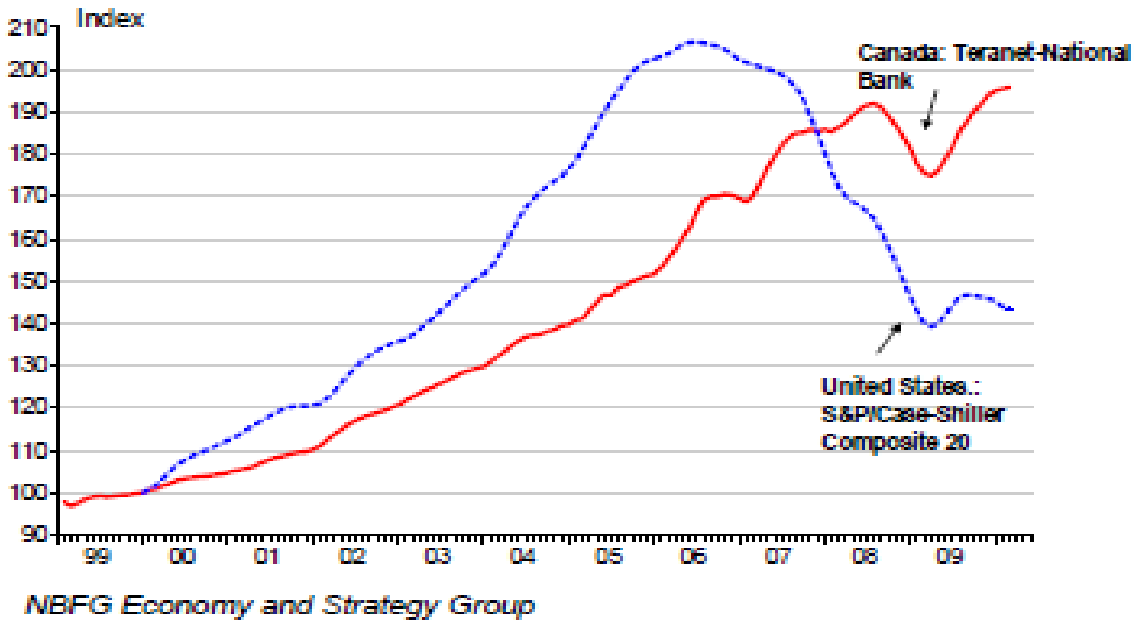
Housing price swings have been more limited than in the US



Source: National Bank

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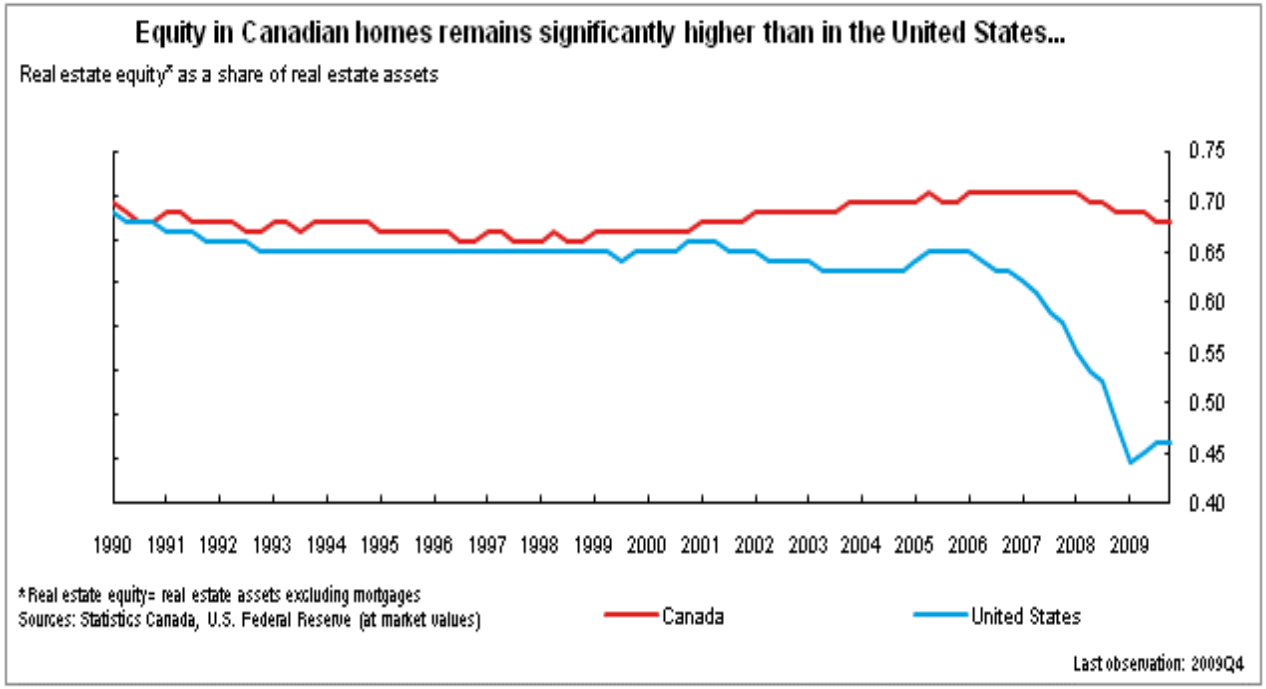
Home equity



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Regulation

- Bank Act: http://laws.justice.gc.ca/PDF/Statute/B/B-1.01.pdf
- Interest Act: http://laws.justice.gc.ca/PDF/Statute/I/I-15.pdf
- Cost of Borrowing (Banks) Regulations: http://laws.justice.gc.ca/PDF/Regulation/S/SOR-2001-101.pdf
- Amendment to Cost of Borrowing (Banks) Regulations: http://www.gazette.gc.ca/rp-pr/p2/2009/2009-09-30/html/sor-dors258-eng.html
- FCAC: http://www.fcac-acfc.gc.ca/eng/default.asp
- FCAC Clear Language: http://www.fcac-acfc.gc.ca/eng/industry/infonews/2009_09_infonews-2-eng.asp

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Legal framework for federal housing policy

National Housing Act (NHA) - introduced in 1944

"The purpose of this Act, in relation to financing for housing, is to promote housing affordability and choice, to facilitate access to, and competition and efficiency in the provision of, housing finance, to protect the availability of adequate funding for housing at low cost, and generally to contribute to the well-being of the housing sector in the national economy."