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PROTECTED

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To CMHC Approved Lenders:

This is a letter to clarify recent underwriting policy changes at Canada Mortgage and Housing Corporation (CMHC) and to request your continued support for our housing and financial system. I wanted to address some misconceptions and explain our rationale. More importantly, I am asking that you continue to support CMHC's mortgage insurance activity in preserving a healthy mortgage sector in Canada.

We understand that first time home buyers comprise valuable new clients for some of you. And we know that you will want to help them to buy homes as long as someone offers them insurance. While we would prefer that our competitors followed our lead for the good of our economy, they nevertheless remain free to offer insurance to those for whom we would not.

We have sustained a reduction in our market share to promote a more competitive marketplace for your benefit. However, we are approaching a level of minimum market share that we require to be able to protect the mortgage market in times of crisis. We require your support to prevent further erosion of our market presence.

Rationale for CMHC Underwriting Changes

In response to weakened economic conditions, effective July 1 we imposed a minimum credit score of 680. Second, we eliminated insurance for people who are borrowing their down payment. And third, we removed exceptions to our minimum debt service requirements. In a call that included colleagues from the Department of Finance, we offered our competitors advance notice of our decision.

Our decision to tighten underwriting standards was driven by economic systemic concerns. There is no doubt that we have willingly chosen to forego some profitable business that our competitors would find appealing. CMHC's purview extends beyond our narrow commercial interests to macroeconomic impacts and there is a dark economic underbelly to this business that I want to expose.

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Economists have repeatedly shown that excessive household borrowing has predictable and consequential negative impacts on future consumption and economic growth. Debt applies money that would otherwise be future consumption to present spending. Too much debt not only increases risk, it therefore slows future economic growth.

In fact, the Bank for International Settlements showed that national household borrowing above 80% of gross income intensifies the drag on GDP growth. Now at a ratio of above 100% gross debt/GDP and headed above 115%, Canada is well above this problematic threshold. It is CMHC's responsibility to reverse this trend. By constraining excessive borrowing. This is also the principal thinking behind the mortgage interest stress test.

Therefore, exposing mortgagees, and first time home buyers in particular, to excessive borrowing creates a very significant economic drag on our outlook. People will indeed pay their mortgages, but in order to do so, they will conserve so much spending that they hold back our economy.

House Price Outlook

We continue to believe house prices will fall, even in the face of recent activity, which appears to be the result of very low interest rates and a sharp reduction in new listings/supply vs underlying demand.

Our projections always anticipated a delayed impact: weakening in late 2020 and 2021 once government income supports unwind, bankruptcies increase and unemployment starts to bite. Weakness in oil-producing regions and sharp reductions in immigration will add further pressure. The economic cost of COVID-19 has been postponed by effective government intervention; it has not been avoided.

This outlook for falling house prices is a second reason to restrain highly-levered mortgage lending. ***We don't think our national mortgage insurance regime should be used to help people buy homes with negative equity.*** That however is exactly what Insurers are offering: 95% LTV mortgages subject to a 4% capitalized insurance fee in the midst of an economic calamity. Aside from the economic cost I mentioned above, we risk exposing too many people to foreclosure. These are individual tragedies that also create conditions for exacerbating feedback loops and house price crashes.

Excessive household borrowing ***will*** make the pain of the deferred COVID-19 economic adjustment worse.

Limiting the Impact

Along with colleagues from the Department of Finance and the Office of the Superintendent of Financial Institutions, we are monitoring market developments. As I said, CMHC cannot stop you from offering insurance that a competitor is willing to provide.

We are concerned that our competitors may be seeking a greater share of lenders' less risky business in return for absorbing business that CMHC has abided, in order to preserve balance in their mortgage book. However, we have long managed risk imbalances in rural and remote markets for which we have not burdened you. More importantly, we object to a competitor asking you (and us) to subsidize their economically counterproductive activity. PMIs are responsible for their decision to take on riskier loans themselves.

In conclusion, I am asking for two things. First, we would hope you would reconsider highly-leveraged household lending. Please put our country's long-term outlook ahead of short-term profitability. Second, please don't aggravate the impact by undermining CMHC's market presence unnecessarily.

Our ability to respond effectively in a crisis will be weakened if our market share deteriorates significantly further. We are particularly concerned that lenders not benefit private mortgage insurers when liquidity is prevalent, only to rush to CMHC for support when it is not. Our market share increased earlier this year, as it tends to do in a crisis. If you want us in wartime, please support us in peacetime.

My colleagues and I would be very happy to discuss these issues with you.

Kind regards,

Evan Siddall
President and Chief Executive Officer

cc: Martha Durdin
President and Chief Executive Officer
Canadian Credit Union Association

Neil Parmenter
President and Chief Executive Officer
Canadian Bankers Association

Leah Anderson
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