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Libro Credit Union response to FSRA Consultation on Draft Residential Mortgage Lending – Interpretation and Approach Guidance, ID: 2020-009

Libro is pleased to respond to the residential mortgage lending guidance proposed by FSRA on September 9th, 2020. This guidance comes at a precarious time for credit unions, our members and the Ontario economy, this must be considered in subsequent discussions, edits, and within implementation.

Libro remains focused on supporting our Owners through the challenges ahead and we recognize that this guidance can ensure continued stability, reasonable growth and enhanced governance around how we lend and support Owners seeking a mortgage or mortgage renewal.

Buying a home remains the biggest financial decision for Ontarians and an important life goal for many. At Libro we seek to ensure that the Owner understands all aspects of the purchase, the product, the process, their options and the impacts on affordability and their financial goals and plans. We believe that these coaching conversations make a critical difference, along with effective credit risk strategies and frameworks. Both must work together to support the Owner.

Credit unions need to remain competitive in a growing field of fin techs, banks and new entities seeking to support mortgage purchases in Ontario. We need a continued collaborative and principled approach from FSRA on this important topic, as the alternative would be a loss in relationship based banking, sector strength and market share to other entities who may, or may not, share the same principles that put member first. We trust that FSRA will partner with us as we work together to enhance the proposed guidance to ensure our ability to take reasonable risks, grow, and support our members and their financial goals is present.

Executive Summary of Recommendations

Libro is generally supportive of the consultation document presented. Our concerns with the current draft relate to the following:

1. **Intruding on Credit Union Culture**: The possibility of scope creep through credit risk and lending examinations relating to credit union culture and strategy requirements due to ambiguous language presented.
2. **Additional Administrative Burdens**: Potential for increased administrative costs due to expanded life cycle monitoring requirements and increased burden related to renewals and ongoing member documentation requirements. The language proposed creates a potential

competitive disadvantage for Ontario credit unions when compared to federally regulated institutions, based on our understanding.

3. **Creating Friction with Members**: The increased possibility of friction between credit unions and members with the additional requirements relating to life cycle monitoring, documentation, financials and renewal requirements.
4. **Expanding the Regulatory Environment**: Additional opportunities for consolidation and clarification exists, relating to current FSRA lending guidance that was not present within the draft.
5. **Implementation Timelines**: The lack of timelines presented for implementing suggested changes. While we recognize that this is still within a consultation phase, we have concerns around the life cycle monitoring requirements and possible technology enhancements needed. We would like to further discuss implementation timelines relating to the guidance and ensuring a long runway for future change due to the potential costs, resources needed and time constraints.

Rationale and Background Response

Libro appreciates the goals, objectives and principles that FSRA has outlined within the guidance document. We were happy to see a clear and concise rationale and background section that outlines the importance of relationships between credit unions and their members. This has not always been present in past guidance documents and we are hoping that this trend will continue moving forward.

We were also pleased to see that FSRA was willing to call out the importance of supervision activities that "allow credit unions to compete effectively and take reasonable risks, intervening only when FSRA is concerned…". This positive commentary is welcomed, and we hope to see more principles of this nature that support proactive growth, strong innovation and respect for the relationships that we have with our members. Some of our concerns relate to ensuring this comment remains committed to throughout the guidance document. We trust that we can continue discussions on how to ensure this is put into action across this document and future ones.

Guidance Concerns and Challenges

Prescriptive Requirements and Creep into Credit Union Culture

We note a few areas within the guidance that links the Board, Senior Management, residential mortgages, and credit risk to corporate culture and strategy using ambiguous language. We recognize how our corporate culture supports our residential mortgage offerings and relationships; however, the language offered creates ambiguity and does little to tie together all elements in a cohesive manner. We fear that the proposed language imposes possible examination challenges and pushback not only on residential mortgage requirements but also on corporate culture and strategy, which we feel should not be a primary focus of the guidance.

Page six of the document asks the question "Have the Board and Senior Management included the credit union's core values and expectations in its residential mortgage credit risk culture, consistent with the overall corporate culture of the credit union?" Additionally, page fifteen of the document under section 4a notes "aligning the Framework with the strategy, objectives, and culture of the credit union" and 4d notes "building inclusiveness and ownership among those affected by risk". This language is, specifically 4d is ambiguous and convoluted in setting expectations and establishing standards and begs more questions related to examination processes. While we support a principles-based approach, too much ambiguity around culture and its connection to mortgages could lead to unintended consequences at examination time and force changes to long term planning, based on the current draft.

Questions arising from the ambiguity:

1. Will FSRA recommend changes to the direction of Libro's corporate culture and strategy as part of its oversight of residential mortgage lending?
2. What is FSRA's definition of the "breadth of a credit unions corporate culture"? Does it include brand statements, media releases, vision and mission statements, CEO public comments, social media content, etc.? Will FSRA examine against all these elements through the mortgage guidance?
3. Linking corporate culture and residential mortgage risk feels anecdotal and difficult to measure against. No quantitative measurement is shared within the guidance. Oversight would be subjective and examination teams may have differing views of culture and how it should impact residential mortgage lending. How would FSRA ensure consistent examinations against culture and its connections to lending and credit risk?
4. We are unsure what "inclusiveness and ownership among those affected by risk" means and how it would be measured against?

We are not opposed to principles relating to corporate culture and overall lending strategies and frameworks; however, within the document as it stands, we feel there is the potential for scope creep into changing corporate cultures and forcing strategy change based on current language and examination unknowns. We would ask that FSRA consider a more simplified approach to their expectations around corporate culture and its relationship with residential mortgage lending; one that prevents possible interference with long term strategies and business planning.

Administrative and Financial Burden Concerns Exist

Libro has concerns that specific sections around data infrastructure, collection and retention of information, collateral re-evaluations and monitoring will increase administrative and financial burdens on credit unions. This would come at a time when margin compression is already placing a burden on credit unions, along with the need to retain higher liquidity and prepare for possible defaults, overdrafts and other additional needs of members. We would ask that FSRA exercise caution in the following areas and consider balancing the guidance principles against the required administrative and financial burden on credit unions.

Life Cycle Monitoring

Page eight of the guidance outlines the requirement and goal of life cycle monitoring for residential mortgages. This will require additional reporting and potentially new software platforms and data infrastructure, which will increase operational costs for credit unions. Small and medium-sized credit unions may not be able to easily meet the technical requirements outlined for relevant and ongoing monitoring information. There will also be large credit unions that will require systems upgrades, at an unknown cost (at this time) and resources to be taken away from serving our members.

Life cycle monitoring requires more discussion to determine exact needs and expectations, to ensure we have the right systems in place to meet future FSRA requirements and examination expectations. We appreciate the questions provided by FSRA; however, they raise further questions relating to data needs and timelines, and how they will align to examination requirements. Libro is on a journey for better-quality data and we look forward to future discussions on this topic.

Collection of Information and Documentation

This area presents challenges in that the framework may conflict with operational capabilities. These requirements could have unintended consequences that run counter to FSRAs stated principles of allowing credit unions to compete effectively and take reasonable risks.

Page ten outlines questions and expectations relating to document collection, ongoing verification, periodic updates, ongoing property analysis and re-evaluations at intervals where a change occurs. The need for these ongoing evaluations, updates and verification beyond the original mortgage application and general renewals will create significant burden on staff time and the credit union's ability to effectively support all members. Additional staff will be required to support these administrative requirements, at an additional cost to credit unions.

It should also be noted that obtaining relevant information from Owners, when not applying for a new mortgage, is difficult and time consuming. It also often causes members to incur additional costs from their accountants and bookkeeping services. In addition, it can lead to an adversarial relationship between the credit unions and our members by creating friction, as the member believes we are not trusting of their ability to repay and support the loan ongoing.

We are not opposed to income verification requirements and other opportunities to enhance the process for approving or renewing a residential mortgage; however, the requirements for ongoing collection of information and member monitoring are extensive. These requirements will make it more difficult for borrowers to bank with a credit union.

Additionally, we have concerns that federally regulated financial institutions are not be required to meet the same standards proposed within the guidance, which will place credit unions at a competitive disadvantage. This is evident in the section outlining requirements relating to renewals and the possibility of re-underwriting the entire mortgage again. It is our understanding that our federally regulated competitors are not required to adhere to this requirement/standard. If we are held to a different standard it creates the opportunity for competitors to take advantage of the additional burden by providing faster renewals with limited back and forth. This friction will cause tension with members and may persuade many to bank elsewhere as ease of access and speed are table stakes within the mortgage market.

We ask that FSRA consider the repercussions of ongoing evaluations, requests for member information, and ongoing property evaluations, costs and fees, all of which carry substantial negative impact back on the sector. We also ask that FSRA ensure our guidance does not place us at a competitive disadvantage to federally regulated institutions and fin techs. We would appreciate a comparative analysis to highlight how FSRA's guidance creates less burden than federally regulated entities.

Overly Prescriptive Guidance for Credit Risk Assessment

Page eleven of the guidance document sets out requirements relating to ratio analysis to "assess a residential mortgage applicants' risk of default, such as; percentage of unsecured debt to income, and Loan to income ratio (LTI)." We believe we meet the principle of this guidance through other types and forms of analysis; however, we are concerned by the prescriptive requirements for additional ratio calculations on each credit request and ongoing monitoring based on the line of questioning and proposed language. It appears that we will not be simplifying these transactions in the future and will be adding additional requirements and burdens as it currently stands.

Broadly speaking we have concerns relating to the approach section of the guidance notes, in that the goal of the document "is to not prescribe compliance requirements for Ontario Credit Unions." This section feels somewhat prescriptive compared to others in the stated expectations from FSRA and future requirements around debt servicing ratios, methodology and stress testing.

If these are in fact simply considerations and not prescribed requirements, then we are misinterpreting the content of the guidance; however, if we are not it would appear that more burden around risk assessment is coming. Additional calculations on each request will hinder growth opportunities and create more friction between our members and mortgage coaches. Finding ways to use established principles, tools and mechanisms without adding unnecessary requirements would be helpful to limit the potential burden on credit unions and members as they seek a mortgage or a renewal.

Opportunity for Consolidation of Guidance

With new residential mortgage guidance there is an opportunity to consolidated current guidance and outdated items within FSRA. We were happy to see that FSRA is seeking to eliminate:

DICO – Lending Advisory #3 May 2012
DICO – Lending Advisory #4 Jan 2017
DICO – Lending Advisory #5 Nov 2017

We also recommend that FSRA consider the 2018 Guidance Note on Lending that outlines the basic elements that will be considered in assessing the effectiveness of the credit risk management framework and is used by FSRA to assess whether a credit union is managing its credit risk in a prudent manner. Now is the opportunity to eliminate this redundant guidance and consolidate into the new principles-based approach. We noted several places where credit risk, standards and risk management frameworks are shared across these guidance documents, which illustrates the opportunity to consolidate.

The overlap of the documents could create confusion within the sector and cause questions around which guidance and interpretation. Upon review of the 2018 document sections that appear to overlap include:

- Values of Security
- Prudent Lender Approach
- Credit Evaluation
- Risk Ratings

- Personal Loans (potentially)
- Residential Mortgage Loans
- Other Collateral Mortgage Loans – Residential Property
- Loan Reports

We ask that FSRA consider how to further consolidate the 2018 Lending Guidance into the new guidance document within this consultation to ensure no overlap or confusion can exist within the sector and to support less burden on credit unions. We also ask that in this review consider reporting requirements that also can be consolidated at the same time.

Effective Date and Timeline Concerns

The guidance presented does not lay out a timeline or runway for the required changes. We are requesting a minimum of two years to implement the guidance in full. The potential requirements and expectations laid out in the guidance could require upgraded systems to support credit granting and monitoring. That process alone can take significant time to fully and effectively implement. We ask that FSRA take this into consideration when building out the expected timeline and effective date for implementation of the guidance.

Conclusion

The goals, objectives and rationale for the proposed guidance is admirable and positive in its approach. We were excited to see language within the guidance that supported credit unions ability to grow and take reasonable risks, as well as the understanding that we know our members exceptionally well and that such relationships should be recognized within the credit risk framework and process of granting a residential mortgage.

We have some concerns as outlined within this response. Some areas feel overly prescriptive, with the potential for scope creep into corporate culture, frameworks, policy and strategy. We also have concerns regarding potential burdens on the sector in relation to financial and administrative requirements, based on the questions and language used. This guidance will certainly require more resources, system enhancements and potentially new policy and processes for many credit unions beyond their current credit risk monitoring. This will negatively impact both credit unions and our members in terms of increased costs, resources and administrative burden. There will be additional cost and challenges in implementation to meet the principles outlined.

There is also an opportunity to further consolidate guidance notes, rules and reporting requirements. We note in our response that we see overlap between the proposed guidance and the 2018 Lending Guidance Note from DICO (previous). We appreciate the goal of reducing burden on the sector and see this as an additional opportunity.

The requirements and potential changes outlined within this document will take time and resources to implement. Libro would require a runway of at least one to two years to establish new policy, processes, systems and platforms to support the proposed questions and expectations within the guidance. Is this the timeline FSRA is considering? Further discussions on this important matter would be helpful with the sector.

Again, we appreciate the new collaborative direction of FSRA, and the rationale and principles outlined within the document. There are challenges and concerns to the guidance, but we believe through collaboration, discussion and further understanding they can be worked out to ensure credit unions of all sizes have the ability to enhance their practices relating to residential mortgages and better protect members and their deposits.

Sincerely,

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