Credit Union Central of Canada

SYSTEM BRIEF

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Credit Unions and Canada's Mortgage Market

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Rob Martin joined Credit Union Central of Canada (Canadian Central) in 1999 as a policy advisor in the Government Relations Department. Over the years Rob has done policy and research work for the credit union system on files including federal financial sector legislation, Farm Credit Canada, the Business Development Bank of Canada, anti-money laundering, privacy, and bankruptcy and insolvency reform. He has provided policy and secretariat support to the CUCC's Legislative Affairs Committee, National Lenders Committee and Canadian Central's Agriculture Working Group. Rob completed a Master's Degree and four years of Doctoral Studies in Political Science with a specialization in international finance.

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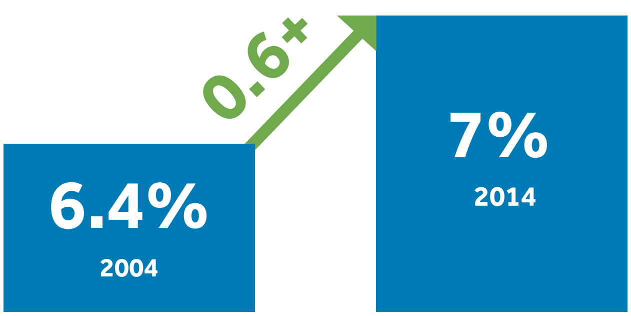
INTRODUCTION

The single biggest investment most Canadian's will make is in their home. It is no surprise then that housing represents almost 40 per cent of an average Canadian family's total assets – roughly equivalent to their combined investments in pensions, insurance plans and the stock market. [1]

It follows from this then, that housing plays a very significant role in the Canadian economy. The Canada Mortgage and Housing Corporation (CMHC) has estimated that housing related economic activity accounts for nearly 17 per cent of the Canadian economy. This figure includes housing construction, purchase, renovation, resale, and spending on housing goods. For at least three decades, residential investment has accounted for an average of approximately six per cent of Canadian GDP. On the credit side, housing is the single largest asset class exposure among Canadian financial institutions. At the end of 2014, Canadian residential mortgage credit outstanding accounted for nearly 70 per cent of all Canadian household credit outstanding. [3]

Outside of Quebec, credit unions are by far the largest non-bank competitor in the Canadian mortgage market. When viewed on a consolidated basis, the credit union system now has mortgage credit outstanding that is on par with BMO Bank of Montreal, one of Canada's largest banks.

Credit Union Mortgage Market Share



For decades, serving the Canadian residential mortgage credit market has been at the center of credit union business. On average, residential mortgage loans make up 58 per cent of all credit union loans. This has remained the case – with mild fluctuation - even while the Canadian housing market has been buffeted by cycles of growth and downturn. [4]

In recent years, credit unions outside of Quebec have been increasingly competitive in the mortgage market and have been gaining market share. In 2004, credit unions outside of Quebec, claimed 6.4 per cent of the residential mortgage market. By the end of 2014 this had increased to 7.0 per cent. This may not appear to be a rapid advance, but it has occurred during a period of increased competition from both the chartered banks and specialized lenders. [5]

The member-owned and local nature of credit unions helps tie credit unions to their communities. These ties are evident in how farm and small business lending directly support producers and companies looking to grow and build their community. The centrality of mortgage lending to credit union business is a further element binding credit unions to their communities. Credit union mortgage lending supports a cycle of local investment: as credit union members deposit funds in their credit union accounts, those funds finance local housing activity and that activity generates revenue for credit unions. This is the virtuous circle of economic development that credit unions support through their residential mortgage lending.

This System Brief will examine the competitive role credit unions play in the residential mortgage market in Canada and compare credit unions to other financial institutions Canada. It will consider the quality of credit union mortgage lending from a consumer perspective, and in terms of loan performance. Finally, this Brief will examine the evolving relationship between credit unions and mortgage insurers (e.g. CMHC) and address some related policy issues of concern to Canada's credit unions.

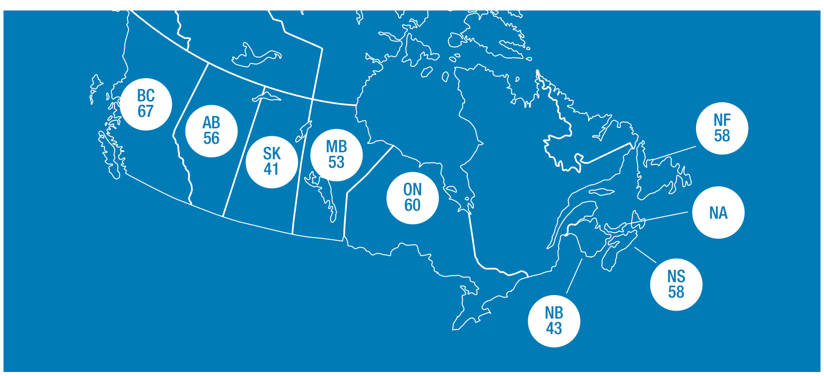
MORTGAGE LENDING: A CREDIT UNION STRENGTH

In the early years, personal loans dominated credit union loan portfolios. For example, in 1961 personal loans accounted for 65.4 per cent of credit union assets while mortgage loans only represented 12.7 per cent of assets.[6] However, from the 1970s onward, the mortgage business has been increasingly important to the credit union system, and the relative weight of personal and agricultural loans have declined.

In fact, residential mortgage lending is now at the center of credit union business. Mortgages comprise over half of all credit union loans with the proportion of residential mortgages in the lending mix, fluctuating between 55 and 60.9 per cent over the last 20 years. The centrality of mortgage lending should not be a surprise given the fact credit unions exist to serve the core financial needs of their owners/members and housing is the most significant purchase most credit union members will make.

At the end of 2014 residential mortgage loans accounted for 58.3 per cent of all loans made by credit unions in Canada outside of Quebec.[7] This is an average number and hides variations among credit unions in different provinces. For example, mortgage loans make up 67 per cent of the loan business for credit unions in British Columbia, while in Saskatchewan this number falls to 41 per cent. This provincial variance (see Table 1 below) is likely the result of the varying dynamics of provincial economies and the relative importance of housing markets in different jurisdictions.[8]

Mortgage Loans a Per Cent of Total Credit Union Loans (%)

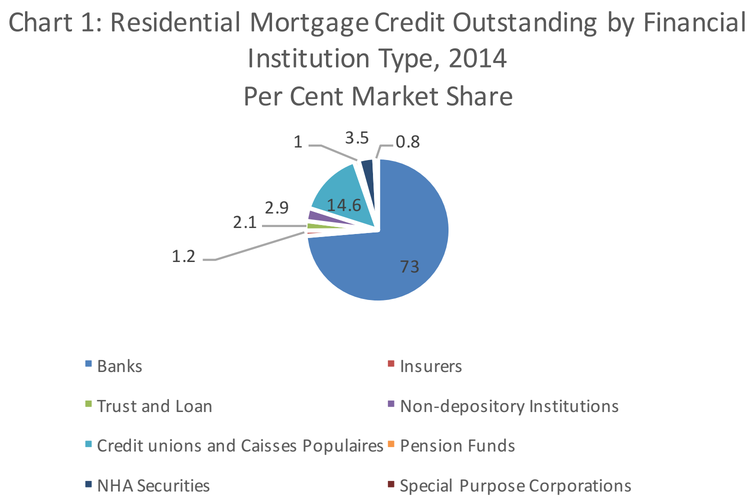


Source: Credit Union Central of Canada: Information Survey, Q4 2014. Data unavailable for PEI in comparable form.

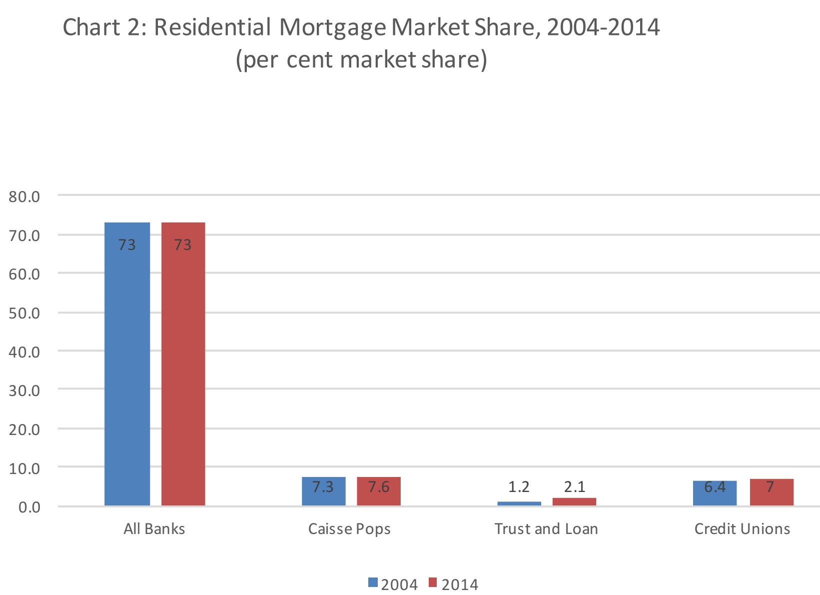
Mortgage loans have also been a consistent source of credit union revenue. The average credit union gross residential mortgage returns have been competitive with those of the chartered banks for the past decade and have continued to provide adequate returns even in a context of historically low interest rates. When interests rates begin to rise toward their historical averages, it is likely that credit union mortgage rates of return will begin to rise again.[9]

CREDIT UNION MORTGAGE MARKET SHARE

The chartered banks dominate the Canadian residential mortgage market. At the end of 2014, the banks operating in Canada had issued $946 billion in residential mortgage credit outstanding, which is equivalent to a 73 per cent market share.[10]



Sources: Credit Union Central of Canada, OSFI, Bank of Canada, CBA, Provincial Centrals, Credit Union Deposit Guarantee Corporations

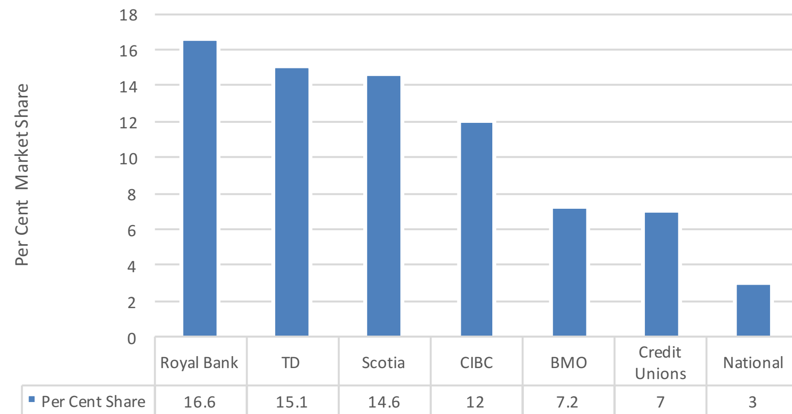


Credit unions and *caisses populaires* (including co-operative Desjardins system in Quebec) are the most significant non-bank competitors in the Canadian mortgage market. At the end of 2014, credit unions and caisses populaires had issued $189.7 billion in residential mortgage credit outstanding. This is equal to an overall 14.6 per cent market share. Non-depository credit intermediaries and "other" financial institutions fall well behind with the third largest market share at only 2.9 per cent. The remaining 9.5 per cent of the market is accounted for by various institutions including insurance companies, trust and loan companies and pension funds.[11] These data are illustrated graphically in the chart to the left.

The figures set out above are for the whole of Canada and aggregate credit union and caisse populaire data. They are therefore not fulling revealing in their representation of the role credit unions play in the mortgage market outside of Quebec and the Territories.[12] A further disaggregated approach is set out in Chart 2 to the left comparing market share numbers in 2004 and 2014.

These numbers reveal that credit unions (outside of Quebec) have seen their market share rise from 6.4 per cent in 2004 to 7.0 per cent in 2014. This is a 9.4 per cent increase over the 10 year period. The banks have seen their market share remain steady at 73 per cent while caisses populaires and trust and loan companies

Chart 3: Mortgage Market Share by Institution, 2014



Source: Bank of Canada, Credit Union Central of Canada. Based on Mortgage Credit Outstanding.

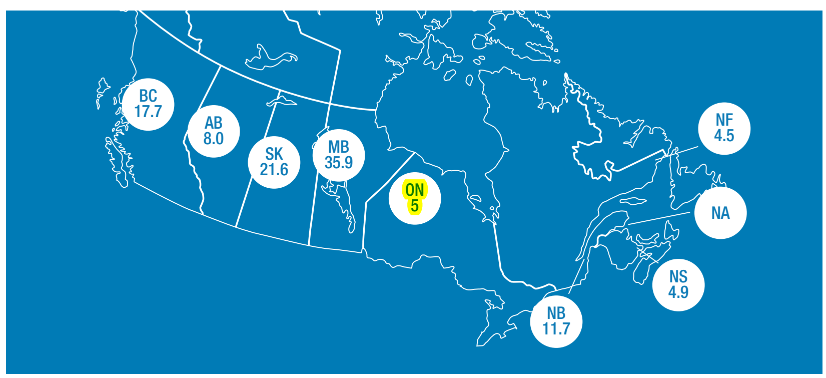
Viewed on a consolidated basis, credit union mortgage lending is just marginally smaller than that of BMO Bank of Montreal, one of the largest chartered banks in Canada (see Chart 3 right).

If current trends continue, we can expect to see credit unions further increase their relative weight in the mortgage market outside of Quebec and the Territories. This is because, on average, credit unions have been increasing their mortgage lending slightly faster than the big six Canada banks considered as a group. Specifically, credit unions have increased their mortgage credit outstanding by an average of 8.92 per cent per year in the five year period between 2009 and 2014. This compares favourably with the chartered banks who saw their mortgage credit outstanding increase by an average of 5.5 per cent per year between 2009 and 2014.[14]

Provincial Market Share

Breaking these numbers down on a provincial basis is even more revealing and shows credit unions playing a significant role in a number of provincial mortgage markets. For example, as the map below indicates, credit unions in British Columbia represent 17.7 per cent of the market. In Saskatchewan this increases to 21.6 per cent, while in Manitoba the figure increases still further to a remarkable 35.9 per cent.

Provincial Credit Union Mortgage Market Share Credit Union vs. Banks (%)



Source: Credit Union Central of Canada, Bank of Canada Economic and Financial Statistics. Based on credit union versus bank provincial data.

CREDIT UNION MORTGAGE LENDING: QUALITY MEASURES

Member Satisfaction

As noted earlier, credit unions have increased their mortgage credit outstanding by an average of 8.92 per cent per year between 2009 and 2014. This rate is moderately faster than that of the chartered banks that saw their mortgage credit outstanding increase by an average of 5.5 per cent per year in the same period.

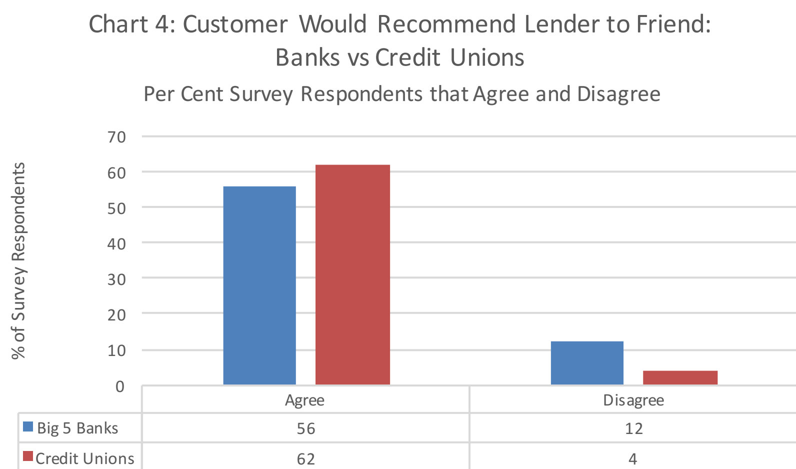
The more dynamic growth in credit union mortgage lending is, in part, attributable to the positive experience credit union members have with credit unions. For eleven years in a row, the Ipsos Best Banking Awards have ranked credit unions as first in "Customer Service Excellence" among all retail financial service providers in Canada.[15]

Similarly, mortgage specific assessments, are available through the regular Financial Industry Research Monitor's (FIRM) regular residential mortgage survey. In the most recent FIRM survey, 32 per cent of credit union mortgage customers "completely agreed" they would recommend their credit union lender to a friend for mortgage business. This far outpaces the results for any other lender in Canada as illustrated in Table 3 to the right.

Table 3: Customer Satisfaction: "Completely Agree" (Would Recommend Lender to A Friend)

	RBC	CIBC	BMO	BNS	TD-CT	National	CU	CP	Other
Completely Agree	23%	20%	21%	24%	23%	21%	32%	22%	23%

Source: FIRM Residential Mortgage Survey, Summer 2015.



Overall satisfaction with credit union mortgage lending also bests the big chartered banks when customers are asked whether they "somewhat" or "completely agree" they would recommend their lender to a friend.

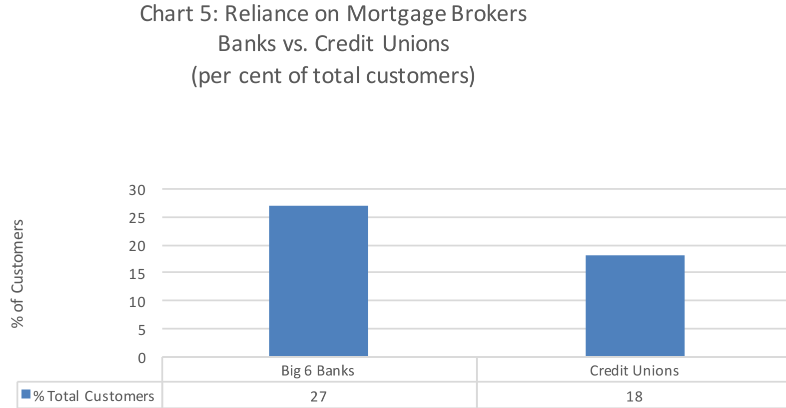
These credit union satisfaction numbers are further supported by FIRM Residential Mortgage Survey data from 2013 and 2014, indicating that credit union customers/members are the most loyal of all the mortgage clients of financial institutions. A full 42 per cent of credit union mortgage clients describe themselves as "entrenched" customer, whereas only 30 per cent of major banks clients do so. This is all the more interesting given that, on average, the chartered banks are very competitive on rates for all terms and types of mortgages.[16]

Limited Reliance on Mortgage Brokers

Another interesting indicator of credit union member loyalty and quality of experience relates to the relative use of mortgage brokers in attracting mortgage business. The percentage of consumers that use a mortgage broker when taking out a mortgage has been steadily rising since 2005, when only 22 per cent of consumers reported using a mortgage broker. Recently, this number has risen to 31 per cent. In 2015, the number was significantly higher – at 40 per cent - for consumers that had taken out a mortgage in the past two years. This development points to an increased commoditization of mortgage products and a general decline in consumer loyalty to a single financial institution when seeking a mortgage. In general, consumers are increasingly willing to look beyond their primary financial institution for a mortgage and they are making a choice of institution largely on price.

However, these general averages disguise significant differences in both: (i) consumer behaviour in relation to mortgage brokers; and (ii) financial institution reliance on the mortgage broker channel to attract business.

For example, the big six chartered banks in Canada rely heavily on the mortgage broker channel to attract business with 27 per cent of total mortgage customers obtained through mortgage brokers. In contrast, only 18 per cent of all credit union mortgage customers have been acquired through the mortgage broker channel.[17] Credit unions, in contrast, are much less reliant on the mortgage broker channel to build and maintain business. This is illustrated in the chart to the right that compares the big six banks to credit unions.



Source: Financial Industry Research Monitor: The Firm Residential Mortgage Survey, September 2015

The lower reliance of credit unions on mortgage brokers should not be surprising given the stronger customer satisfaction and loyalty displayed by credit union customer/members in the FIRM survey data.

Mortgage Arrears

Credit unions focus their business on relatively discrete local markets and tend to retain lending personnel and account managers for longer periods of time when compared to other lenders. The result is that credit unions "know their customer" and "know their market". The benefits of this local knowledge can be seen in the quality of credit union mortgage lending – particularly in regard to mortgage arrear rates and CHMC assessments of the performance of credit unions using CMHC mortgage insurance products.

Publicly available statistics helpful in assessing and comparing the quality of residential mortgage lending among lenders are difficult to obtain, but there are some data to suggest that credit union mortgage lending is well-managed and prudentially sound.

First though, it should be noted that the overall arrears rate on CMHC insured mortgages was very low at 0.35 per cent for all lenders at the end of 2014. This is no doubt the result of the result of low interest rates, slow but steady economic growth, strong underwriting standards girded by a business model designed for sustainability, and supported by effective regulation. The arrears rate for specific mortgage insurance products are set out in Table 4 above.

Table 4: CMHC Mortgage Arrears Rate 31 December 2014

Mortgage Insurance Product	Transactional Insurance	Portfolion Insurance	Multi-unit Residential
Arrears Rate	0.52%	0.15%	0.62%

Source: CMHC, Mortgage Loan Insurance Business Supplement, Second Quarter, 2015. P 13

Data that specifically disaggregates these figures by type of lender are not publicly available, however, CMHC does break down mortgage arrears rates for insured mortgages that form part of National Housing Act Mortgage Backed Securities (NHA MBS) pools. These data compare federally regulated institutions, provincial regulated institutions, "IIROC[18] regulated institutions and "Other" institutions. If we treat the arrears rate for "provincially regulated institutions" as a proxy for credit unions, the data suggest credit union mortgages have very low arrears when compared to other institutions. In fact, the data in Table 5 below indicates that the mortgage arrears rate for credit unions is below that of the average overall arrears rate and – as of March 2015 – below that of all other institutions with mortgages in NHA MBS pools. These numbers suggest credit unions have a relatively cautious and prudent approach to assessing the mortgage loans they underwrite.

Table 5: Mortgage Arrears Rate in NHA MBS Pools, 2014-2015

90 Days Arrears for Mortgages in NHA MBS	31-March-2015	31-March-2014
Overall 90 days arrears rate	0.27%	0.21%
Federally Regulated Institutions	0.29%	0.22%
Provincially Regulated Institutions (CU proxy)	0.13%	0.16%
IIROC Regulated Institutions	0.19%	0.18%
Other Institutions	0.15%	0.15%

Source: CMHC, Securitization Business Supplement, First Quarter 2015, p. 5.

CMHC Quality Assessment Reports

Another key measure of the quality of credit union mortgage lending are the Quality Assessment Reports (QARS) issued by CMHC. These QARs measure the performance of credit unions using CMHC mortgage insurance products against the averaged performance of all lenders.

The QARs reviewed as part of this research project indicate that – while there are fluctuations in credit union performance - credit unions using CMHC insurance products hit and often outperform industry averages when measured assessed against key CMHC assessment variables. These variable include:

1. **Five year mortgage insurance claim rates:** On average, credit unions make fewer claims on CMHC mortgage insurance relative to other financial institutions.
2. **Save Rate:** This is a measure of underperforming loans that result in claims against CMHC insurance. CMHC's measure of loan save rates indicate that credit unions generally perform better than average and credit unions do a better job at ensuring problem mortgage loans do not result in a CMHC insurance claim.
3. **Early Delinquency Rates (EDR):** This is measure of the quality of new mortgage loans being made. Credit union "EDRs" are generally better than industry average.
4. **Misrepresentation Susceptibility Index (MSI) Rates:** The MSI is a measure of a financial institution's ability to detect mortgage related fraud and misrepresentation by borrowers. CMHC measures of credit union MSI rates are generally better than the industry average.

Viewed from both a prudential perspective and a consumer perspective, Canadian credit unions have shown themselves to be leaders in customer satisfaction in the mortgage market, and effective and responsible managers of their mortgage loan books.

CREDIT UNIONS AND MORTGAGE INSURANCE

In Canada, mortgage insurance plays an important role in helping financial institutions manage risks associated with mortgage lending while facilitating consumer access to mortgage credit and housing.[19] From a macro-economic perspective, mortgage insurance also functions to maintain a stable financial system during a housing related downturn. Also, from a more specific credit union perspective, mortgage insurance plays a further role in facilitating mortgage finance in rural and remote areas or in regions with limited economic activity.

Mortgage insurance requirements are established by the federal government. Federally-regulated lenders and most provincial regulated financial institutions are required to obtain mortgage insurance for mortgages that exceed 80 per cent of the value of a residential property. In the event of a buyer default, mortgage insurance policies insure the mortgage lender against risk of loss for the unpaid balance (plus interest) on the underlying mortgage.

The premiums for the mortgage insurance contracts are set by mortgage insurers and vary according to the loan-to-value ratio of the mortgage loan. Approved mortgage insurers in Canada include Genworth Financial, Canada Guaranty and the CMHC. CMHC is a federal government agency that operates on a broadly commercial basis and is expected to provide a reasonable return to the government.

CMHC is the dominant player in the mortgage insurance market. At the end of 2014, CMHC reported it had $543 billion of mortgage insurance in force - $57 billion short of its legislated cap of $600 billion. Genworth Canada is playing an increasingly important role in the market with a reported insurance in force of $356 billion.[20] In recent years, credit unions have been doing more business with Genworth and credit unions now account for approximately 20 per cent of Genworth's high loan-to-value mortgage insurance written in 2014.

Credit unions have viewed CMHC as a key partner in serving the Canadian residential mortgage market. This is, in part, due to the fact that CMHC has a mandate to provide mortgage loan insurance for transactional homeowner, portfolio and multi-unit residential units in all parts of Canada, including areas or markets that are under-served by private mortgage insurers. Currently, there are over 380 communities in Canada in which a credit union is the only financial institution physically present and thus the CMHC mandate often aligns well with the rural and small urban focus of many credit unions.[21]

Recent estimates indicate that credit unions direct up to 80 per cent of their mortgage insurance business to CMHC.[22]

Mortgage Insurance - Changes Afoot?

Since the financial crisis, policy-makers have identified housing finance as a key driver in the global financial drama. They have emphasized that poorly designed and regulated mortgage finance systems allowed financial institutions to take excessive risk that undermined financial stability.

While Canada has not been hit by a housing market crisis, Canadian policy makers have made significant changes to the rules that govern residential mortgage underwriting in an effort to "de-risk" the market. These changes include:

- Maintaining a $600 billion statutory cap on CMHC's insurance-in-force.
- Reducing the amount of portfolio insurance CMHC can write.
- Reducing the maximum amortization period for insured mortgages from 35 years to 25 years.
- Eliminating insurance for home equity lines of credit.
- Imposing caps on debt service coverage ratios (e.g. 39 per cent GDS ratio and 44 per cent TDS ratio).
- Require borrowers to meet standards for a five-year fixed rate mortgage even if they choose a mortgage with a lower interest rate and shorter term.
- Eliminating the sale of mortgage insurance for purchases of homes worth more than $1 million.
- Requiring a minimum down payment of 20 per cent for government-backed mortgage insurance on non-owner-occupied investment properties.
- Increasing the minimum down payment for new insured mortgages from 5 to 10 per cent for the portion of the house price above $500,000. (This comes into force on February 16, 2016).
- Introducing a residential mortgage underwriting guideline (B-20) to tighten lending standards of federally regulated financial institutions to the mortgage market.
- Eliminating the availability of mortgage insurance (through CMHC) for second homes, certain self-employed borrowers and condominium construction.
- Imposing tighter OSFI regulatory guidelines on residential mortgage insurers.
- Strengthening (by 2017) OSFI capital requirements for federal deposit taking institutions (i.e. the large banks) that use internal-rating based models to establish mortgage default risk and capital off-sets.
- Increasing the CMHC upfront guarantee fee for NHA MBS to 80 basis points (from 60) for amounts issued by an entity in excess of $7.5 billion (versus $6 billion previously).

Despite these changes, the debate has continued about Canada's mortgage insurance framework. This debate has focused on further reforms to reduce potential risk and ensuring current rules do not erode incentives for lenders to effectively manage lending risk.[23] There have been calls for the privatization of the CMHC and the withdrawal of government guarantees from private mortgage insurers such as Genworth Canada.[24] The IMF has suggested Canada review the need for extensive government-backed mortgage insurance and consider privatization in the manner Australia pursued in the 1990s.[25]

The public debate in Canada has not been characterised by a strong focus on privatization but rather on policy recommendations – "sandbox measures" – aimed at promoting more effective risk management at financial institutions and protecting taxpayers from liabilities in the event of a housing crash.

From a credit union perspective, three CMHC related policy recommendations stand out as issues of concern and deserve further critical scrutiny.

1. Imposing an Insurance Deductible on CMHC Mortgages

The Organization of Economic Cooperation and Development (OECD) has noted that, outside of Canada, many mortgage insurers impose a significant deductible on insurance claims. This means that mortgage insurance in other countries often only covers 10 per cent to 30 per cent of the remaining mortgage balance in a default situation.[26] Financial institutions in other jurisdictions, therefore, often take on considerable risk associated with housing loans. In Canada, mortgage insurance covers the full amount of a loss thus minimizing potential losses on insured mortgages.

The OECD has recommended CMHC impose a deductible on mortgage insurance contracts to align the interests of the lenders and those of the insurer, thereby reducing moral hazard.

The OECD has not suggested the size of deductible that should be imposed and, to date, the government has not acted on this policy recommendation. That said, former Conservative Finance Minister Joe Oliver has publicly suggested this is an idea his government was considering.   Any move to impose such a deductible would re-percuss through the Canadian credit union system in a number of ways, including, for example, impact risk weighting on mortgage assets, potentially impinge on credit availability in rural areas, and likely lead to higher funding costs.

2. Reducing CMHC's Role in the Mortgage Market

The OECD has suggested Canada reduce CMHC's dominant role in the market by progressively lowering the amount of insurance it can write. This is currently capped at $600 billion. This proposal would see CMHC's role in the mortgage insurance market decline and private insurers would be expected to fill the gap left by CMHC.[27] Over the longer run, the insurance activities of CMHC might even be privatised and the government's role to one of guaranteeing only against catastrophic losses.

3. Reducing the Availability of CMHC Low Ratio Mortgage Insurance

In recent years federal government and CMHC have been reconsidering the product mix available through CMHC and have moved to reduce or eliminate the availability of some mortgage insurance products (e.g. Second Home mortgage insurance). The federal government has also considered gradually limiting the insurance of low-ratio mortgages (mortgages with a loan-to-value ratio of 80 percent or less) to only those mortgages that will be used in CMHC securitization programs. In fact, they have made some moves to reduce the availability of low ratio mortgage insurance by establishing qualification criteria that imposes maximum house prices, amortization periods and debt servicing ratios for the borrower.

A Credit Union Perspective on Mortgage Insurance Reform

The credit union system understands that, since the financial crisis, the federal government is concerned with promoting effective management at financial institutions and protecting tax payers from potential liability. To those ends, it is understandable that officials continually review policy and make adjustments to CMHC.

However, from a credit union perspective, the proposals noted above do raise concerns that CMHC's longstanding commitment to facilitating home-ownership among Canadians, and assisting under-served areas, may be eroded by these measures should they be implemented.

The application of a deductible to mortgage insurance contracts will lead to a reassessment of mortgage related lending risk at both credit unions and banks. If a deductible is significant, the likely impact will be increases in mortgage credit costs for consumers and a reduction in mortgage credit availability for some aspiring home buyers. The impact of these changes will be most significant for lower income Canadians, Canadians living in rural/remote regions, or in areas with a fragile economic base. These impacts are a particular concern for credit unions because credit unions often operate in rural areas or small urban centers with less diversified economic activity. In fact, there are now 380 communities in Canada in which a credit union is the only bricks and mortar financial institution present. These outcomes would also be at odds with CMHC's role to serve underserved areas and fill gaps in the market.

Reducing the cap on the amount of mortgage insurance CMHC can write will have similar impacts because it is unlikely private mortgage insurers (e.g. Genworth Financial) will seek to serve rural and remote markets in the absence of significantly higher premiums. That said, these impacts may be offset if CMHC's mandate was adjusted to focus more exclusively on serving lower income Canadians aspiring to home ownership and to assisting those seeking to buy homes in rural and remote regions.

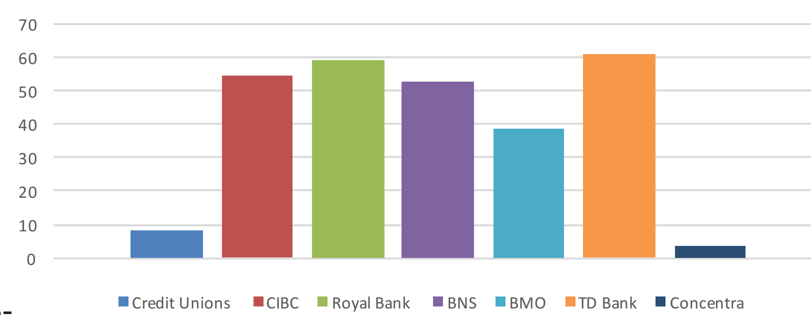
Finally, the elimination of low-ratio transactional mortgage insurance may have similar negative impact on aspiring home owners in small urban centers and rural areas. Currently, low ratio, transactional mortgage insurance helps credit unions provide financing on properties in rural housing markets where sales activity is low. For example, there are situations when a loan to value ratio on a rural property may appear reasonable, but appraisals on such properties may have been developed with thin market data owing to illiquid local housing markets. In this context appraisers can struggle to arrive at final valuations and those appraisals are less certain than those found in active urban markets. In such situations mortgage insurance on a low-ratio mortgage can help a credit union to mitigate property risk and provide comfort to a credit union in issuing the loan.

The volume of these loans is relatively low, making it unlikely individual credit unions would use these loans in CMHC securitization programs. Rather, the elimination of this mortgage insurance option would limit the ability of credit unions to make mortgage loans in rural areas and thus make home ownership a greater challenge in rural and remote areas. From a public policy perspective, low-ratio mortgage insurance is currently playing an important role in facilitating home ownership in rural areas that may be under economic pressure or that may be suffering the effects of an under-developed economic base. In our view, it is appropriate for a Crown corporation such as CMHC to play this role in the market. It would be very unfortunate if CMHC were to remove this important support for rural Canadians.

MORTGAGE BACKED SECURITIZATION AND THE CREDIT UNION SYSTEM

Unlike the banks, the credit union system does not rely heavily on securitization to source funds for their mortgage lending. Instead, credit unions tend to be funded in a traditional way and build their mortgage lending off of deposits and retained earnings. To the extent that credit unions do engage in securitization, it is almost exclusively through the CMHC's securitization guarantee programs. These CMHC programs enable approved financial institutions to pool eligible mortgages and transform them into marketable securities that are sold to investors, thus helping fund additional mortgage lending. The timely payment of interest and principal on these securities (National Housing Act Mortgage-Backed Securities issued by financial institutions and Canada Mortgage Bonds issued by the Canada Housing Trust) are fully guaranteed by the Government of Canada, through CMHC.

Chart 6: Relative use of CMHC Securitization Facilities
Credit Unions vs Big 5 Chartered Banks
2014, Billions of Dollars



Source: Concentra Financial. Note credit union value includes Central 1.

Currently there are 40 CMHC approved credit union NHA mortgage-backed securities issuers within the system. Concentra Financial and Central 1 are also credit union system affiliated approved CMHC NHA-MBS mortgage-backed security issuers. As can be seen in Chart 6 on page 14, credit unions – even when considered on a consolidated basis – are relatively small issuers of NHA mortgage-backed securities.

Although credit unions are currently low volume issuers of NHA mortgage backed securities, they still appreciate how valuable the CMHC sponsored securitization programs can be and recognize these programs could become more important sources of credit union funding and liquidity in the future. These programs help small lenders like credit unions to compete more effectively with larger financial institutions and contribute to lower funding costs for mortgages and greater choice in the market for consumers. Credit unions as smaller, co-operatively owned institutions, do not have access to the wide variety of funding and capital market tools that other joint stock banks do thus make these programs particularly important for the competitiveness of the credit union system.

CONCLUSION

Credit unions in Canada outside of Quebec have proven themselves to be effective competitors in the residential mortgage market. At the end of 2014, the volume of credit union mortgage lending to Canadians outside of Quebec has come to rival that of one of Canada's largest banks, BMO Bank of Montreal. This success owes a great deal to the quality of credit union service when it comes to mortgages, and the loyalty and trust credit union members place in their credit unions. Credit unions consistently score at the top of class in terms of service quality. From a prudential perspective credit union mortgage lending has proven itself to be sound as seen in the CMHC data offered above.

The strong relationship between CMHC and the credit union system has been an important part of credit union success in the mortgage market. The joint commitment to serve the whole of the Canadian market – often in underserved remote regions of the country – has served Canadians well. It is important that government do not loose sigh of this when it comes to reforming CMHC mortgage insurance offerings in the future. CMHC has also played an important role in offering mortgage securitization programs that are useful and accessible to the credit union system. Once again, Canadians benefit from this relationship and will continue to do so - so long as the federal government does not lose sight of the important public policy role CMHC is playing currently.

REFERENCES

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[4]The main other area of credit union growth has been in the small and medium sized business market which has grown from 9.9 per cent in 2004 to 11 per cent of the market in 2013.
[5]Credit Union Central of Canada Research (2014) Credit Union Market Share versus Competitors. Sources: OSFI, Bank of Canada, Statistics Canada, CBA, Provincial Credit Union Centrals. Note: At the end of 2014 credit unions had a total 4.7% financial market share in Canada (i.e. based on comparisons of domestic assets of all Canadian financial institutions).
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[10]Canada Mortgage and Housing Corporation. (2005) Canadian Housing Observer. p. A11.
[11]Canada Mortgage and Housing Corporation. (2015) Residential Mortgage Credit Outstanding, By Institution Type, 2002-2014 Q4. See: http://www.cmhc.ca/en/hoficlincl/homain/stda/data/data_005.cfm
[12]Credit unions do not operate in Quebec, the Yukon, the North West Territories or Nunavut.
[13]Author's calculations based on Credit Union Central of Canada data. The 2014 bank data reflect new (2011) International Financial Reporting Standards (IFRS) that require residential mortgage loans securitized under the NHA mortgage-backed securities (NHA-MBS) program be brought back on to the balance sheet of respective lenders or issuers. The 2004 bank data did not reflect these new requirements. To ensure the 2004 and 2014 bank data were comparable the author added the 2004 NHA MBS residential mortgage credit outstanding numbers to the bank residential mortgage outstanding numbers. The banks are, by far, the largest issuers of NHA-MBS.
[14]See: Canada Mortgage and Housing Corporation, (2015) Residential Mortgage Credit Outstanding, By Institution Type, 2002-2014. Author's calculation based on comparing arithmetical mean of consolidated Big 6 bank and consolidated credit union annual growth rates over a five year period (2009 to 2014).
[15]IPSOS. (2015) Ipsos® 2015 Best Banking Awards. See: IPSOS 2015
[16]FIRM, The FIRM Residential Mortgage Survey, Summer 2015. p. 51. On average, credit unions do not offer the lowest mortgage rates in the market but, instead, differentiate themselves in terms of the quality of service and lending experience.
[17]New mortgage customers includes customers that took out a mortgage in the past two years. See: Financial Industry Research Monitor, Firm Residential Mortgage Survey, Spring 2015 (June 2015).
[18]IIROC stands for the Investment Industry Regulatory Organization of Canada.
[19]Nearly 65 per cent of all mortgages in Canada are insured. See: OECD (2014) OECD Economic Surveys: Canada, p. 13.
[20]Genworth Canada. (2015) Genworth MI Canada INC, Annual Information Form, p, 16. Canada Guaranty does not report on insurance in force but they are considered a small player in the Canadian market.
[21]There are 380 communities in Canada in which a credit union is the only bricks and mortar financial institution present.
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[25]IMF. 2014. Canada: Financial Sector Stability Assessment, IMF Country Report No.14/29. p. 15.
[26]OECD (2014) OECD Economic Surveys: Canada, p. 13; Bank for International Settlements (2013) Mortgage Insurance, Underwriting Cycles and Policy Implications, p. 13. While mortgage insurance in Germany, Hong Kong, the United Kingdom and the United States has coverage between 10 per cent and 30 per cent it should be noted that in Australia, France and the Netherlands coverage remains at 100%.
[27]It should be noted that even with the current cap in place CMHC's relative size in the market will decline as – over time - the mortgage market grows.

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