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Canada Adds Guidelines for Banks to Prevent Mortgage Defaults

Canadian banks need to take steps to assist mortgage holders who are struggling to stay above water after a rapid spike in interest rates, according to new guidelines issued Wednesday.

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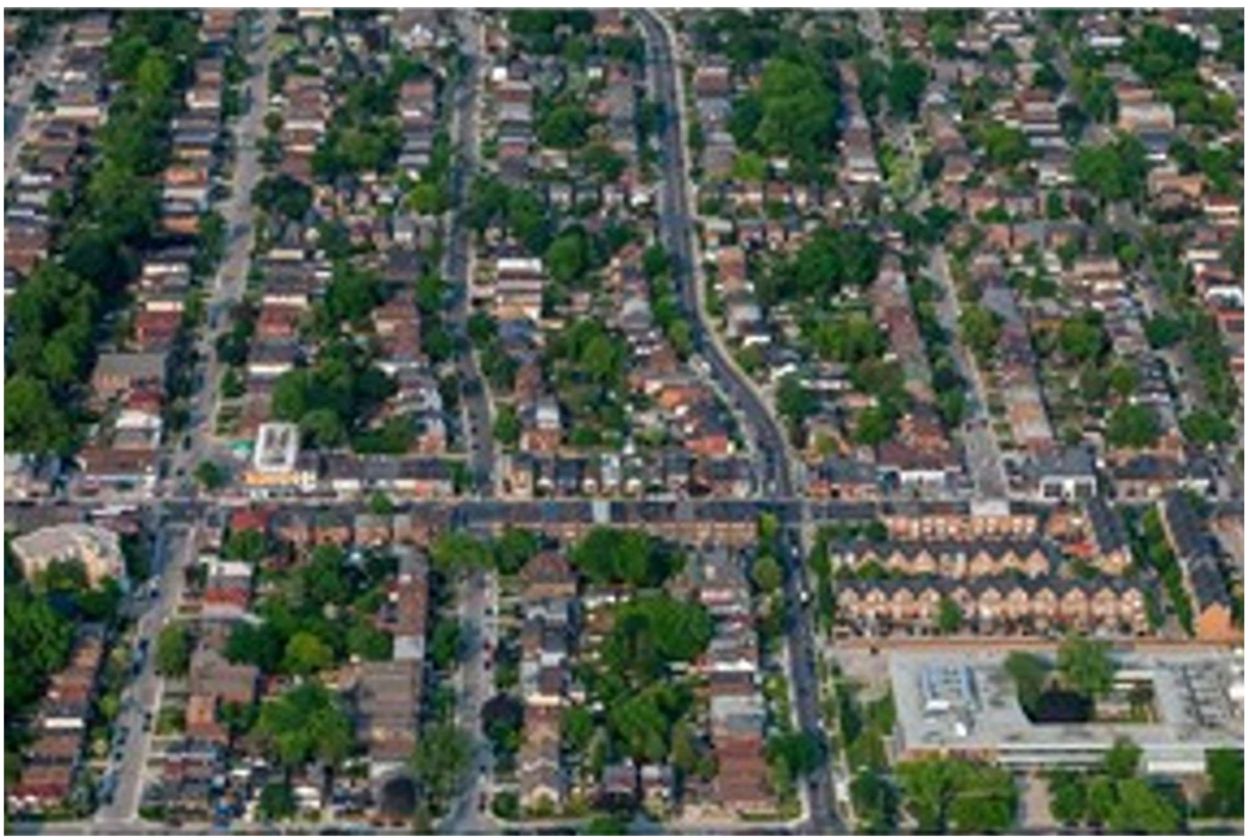
Ari Altstedter || Jul 05, 2023



Homes in Toronto, Ontario, Canada, on Wednesday, June 21, 2023. Canada is scheduled to release gross domestic product (GDP) figures on June 30. PHOTO BY JAMES MACDONALD /Bloomberg

(Bloomberg) — Canadian banks need to take steps to assist mortgage holders who are struggling to stay above water after a rapid spike in interest rates, according to new guidelines issued Wednesday.

Recommended measures include waiving any fees for lump sum or pre-payments made to reduce the debt burden or for selling the house to pay back the loan entirely, according to the new guidelines released Wednesday from the Financial Consumer Agency of Canada. The guidelines also spell out ways for banks to reduce a borrower's monthly payment by giving them a longer timeline to pay the full loan back.

"Today's economic environment is characterized by high household debt, increased cost of living and higher interest rates," the FCAC said in a statement. "As a result, some mortgage holders are at risk of not keeping up with their regular payments."

Canadian homeowners are grappling with the effects of one of the most abrupt interest-rate increases in the country's history, with the Bank of Canada quickly raising its benchmark interest rate last year in a bid to calm inflation. Despite a pause this year, the central bank is now contending with an economy that's regaining momentum. Markets are currently betting on at least one more rate hike this year.

Concerns about the real estate sector are particularly acute in Canada given the prevalence of variable-rate mortgages. In many cases, the interest rates on those loans have already risen so much that the borrowers' set payments are no longer enough to cover even the monthly interest, causing the size of the loan to increase.

Negative Amortization

Canadian banks have been seeing a rise in such negatively amortizing mortgages, with the expected time for a borrower to pay back the loan sometimes stretching past 30 years. At least one quarter of the Canadian mortgage portfolio at Toronto-Dominion Bank, Bank of Montreal and Canadian Imperial Bank of Commerce are now in that category. And nearly a third of Royal

Bank of Canada's domestic borrowers are are covering their interest only, so their amortizations are extending too.

The government's new guidelines are an attempt to pressure Canadian banks to offer more relief to customers in this situation. Other recommendations include not charging interest on the unpaid portion of interest that's being added to the loan's principal each month and waiving internal fees.

If borrowers need to be given more time to keep their payments manageable, the government guidelines say the new timeframe for paying back the mortgage should be "reasonable." Lenders should include information to help the borrower get back to their original payment schedule and explain the negative implications of carrying the debt over a much longer period.

The government's guidelines also recommend the same mortgage relief measures apply to fixed-rate borrowers nearing the end of their term who will need to refinance at the new, higher rates. Since fixed-rate mortgages in Canada tend to need to be renewed every five years or so, even those borrowers may find themselves coming under pressure.

For borrowers who need to refinance, banks should "not offer a less advantageous rate" because those customers may be unable to qualify with a different lender.