Autorité des marchés financiers (AMF) reminder to financial institutions authorized to operate in Québec regarding credit granting in the commercial real estate market

In this economic environment marked by interest rate hikes and persistent inflation, the AMF wishes to remind financial institutions of the importance of following sound and prudent management practices and adhering to sound commercial practices in credit granting activities.

To protect depositors, foster public and business confidence in financial institutions and promote the availability of high-quality financial products and services, the AMF continuously monitors the market to anticipate vulnerabilities that could have an impact on financial institutions and their clients.

This notice is intended as a reminder of some of the expectations set out in the AMF's guidelines that are relevant to credit granting practices. Although in some cases the expectations in the guidelines are not specifically aimed at credit granting in the commercial real estate market, they are still applicable, with the necessary modifications.

Segment	Description of expectations
Commercial real estate	Although the *Residential Hypothecary Lending Guideline* does not specifically cover the granting of credit in commercial real estate, the criteria proposed in the guideline, including assessment of a borrower's repayment capacity, debt service coverage, and the collateral value used to calculate the Loan-To-Value (LTV) ratio, may be applicable when granting these types of loans. The AMF reiterates its expectations regarding sound commercial practices, governance and sound and prudent risk management in respect of commercial lending. These expectations are set out in the *Governance Guideline*, the *Integrated Risk Management Guideline*, the *Capital Adequacy Guideline* (available in French only), the *Stress Testing Guideline* and the *Sound Commercial Practices Guideline*. *"[The AMF expects senior management of the financial institution to implement] a risk management policy and risk management procedures that are adapted to the financial institution's risk profile and strategic plan, and ensure that they are rolled out efficiently and effectively at all levels."*[1] Financial institutions may put in place detailed underwriting criteria for all types of loans, including commercial loans. Such criteria may include term length, maximum loan amount, maximum LTV, borrower collateral valuations, assessment of the borrower's financial condition, approval delegations and loan syndication agreement criteria. Any breach of these limits should be reported and adequately followed up on. *"[The AMF expects borrowers] and facilities [to] have their ratings refreshed at least on an annual basis. Certain credits, especially higher risk borrowers or problem exposures, must be subject to more frequent review. In addition, financial institutions must initiate a new rating if material information on the borrower or facility comes to light."*[2] The institution may implement processes for obtaining the documents needed to assign ratings and assess a borrower's financial condition (e.g., collateral valuations, vacancy rate, statement of revenue and expenses, etc.). An analysis could be conducted to assess how cyclical

[1] Integrated Risk Management Guideline
[2] Capital Adequacy Guideline

	economic trends and stress events may impact loan performance and borrower risk. "Financial institutions will need standardized processes and reliable information systems that allow them to identify connections between risks and to obtain reports that contain relevant, clear and adapted information in a timely manner so that senior management and the board of directors can monitor the achievement of the institution's strategic objectives."[3] Portfolio data and risk reporting systems should be sufficient to identify, assess, quantify, monitor and adequately follow up on the risks associated with commercial lending. "Rigorous, forward-looking stress testing that identifies possible events or changes in market conditions that could adversely impact the financial institution should be performed."[4] Loan portfolio segments, geographies and markets, for example, should be monitored with sufficient granularity to permit identifying areas of concern. Financial institutions with loan portfolios concentrated in a particular market segment could be severely impacted in stress/crisis situations. "*The risk appetite statement should contain qualitative information that makes it possible to situate the targeted risks as well as the desired behaviour of the institution based on different scenarios. The statement should also contain a few quantitative objectives or limits, expressed on the basis of revenue, capital or any other metric deemed relevant (for example, based on maximum loss or level of concentration).*"[5] "*[Senior management should ensure] that staff members who offer products receive training, periodically and as needed, on established FTC-related policies, processes and procedures.*"[6] Commercial loans may have characteristics that differ from standard residential loans. Accordingly, specific training on the policies and processes associated with this type of product should be in place to promote the fair treatment of clients. "*The AMF expects clients to have information, before or when a product is offered, that allows them to be properly informed in order to make an enlightened decision*."[7] The information provided to the client before or when a commercial loan is offered should clearly set out the client's rights and obligations, including the right of cancellation or rescission. Clear disclosure enables clients to properly understand and assess the product. "*The AMF expects clients to have information allowing them to be properly informed, in a timely manner, in order to make enlightened decisions about the products they hold*."[8] Disclosure to clients after a product is purchased (e.g., disclosure of the options they can exercise or of changes to the contract) should be clear and timely. The financial institution should also ensure that clients receive ongoing and adequate service after they are granted a commercial loan.

If you have any questions, please contact:

[3] Integrated Risk Management Guideline
[4] Capital Adequacy Guideline
[5] Integrated Risk Management Guideline
[6] Sound Commercial Practices Guideline
[7] *Ibid*.
[8] *Ibid*.

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