Strategic Advisory Report

OSFI Guideline E-23 — Model Risk Management

Final Guideline Analysis and Compliance Framework

For Canadian Mortgage Brokerages

Prepared For:	Dominion Lending Centres Group (DLCG)
Prepared By:	Matthew Dobson, AVA Credit Inc.
Report Date:	January 1, 2026
Document Status:	Final Advisory — Post-Guideline Release
Compliance Date:	**May 1, 2027**

Document History

This report supersedes the preliminary Strategic Advisory Report issued July 14, 2025, which analyzed the draft Guideline E-23 and projected downstream compliance implications for mortgage brokerages. Following OSFI's publication of the final guideline on September 11, 2025, this updated report reflects the definitive regulatory requirements and revised compliance timeline.

1. Executive Summary

On September 11, 2025, the Office of the Superintendent of Financial Institutions (OSFI) published the final version of **Guideline E-23 — Model Risk Management**. This guideline takes effect **May 1, 2027** for all federally regulated financial institutions (FRFIs) in Canada, including banks, trust companies, and insurance companies.

The final guideline explicitly includes artificial intelligence and machine learning (AI/ML) models within its scope. OSFI kept the model definition intentionally broad despite industry requests for narrower scope. Every tool that transforms data inputs into results that inform business decisions—including large language model (LLM) interactions—falls within the regulatory perimeter.

Core Implications for Mortgage Brokerages

While mortgage brokerages are not directly regulated by OSFI, the guideline's third-party risk management provisions create inevitable downstream compliance obligations. Under E-23, FRFIs must ensure that models sourced from or operated by third parties—including mortgage brokers—receive the same governance treatment as internal models.

> ***Working Thesis:*** *Federally regulated lenders will contractually flow E-23 compliance requirements to mortgage brokerages. Brokers using AI tools for any business purpose—client communications, underwriting support, marketing content, deal structuring—will need to demonstrate governed AI usage through prompt logs, validation records, and evidence of data protection protocols.*

Key Takeaways

- **Compliance deadline: May 1, 2027** — 16 months from this report's date
- **Broad model definition retained** — AI/ML methods explicitly included; LLM prompts may constitute regulated models
- **Third-party accountability unchanged** — FRFIs must govern vendor and broker AI usage to the same standard as internal models
- **Negligible risk pathway introduced** — Low-risk AI use cases may qualify for lighter governance treatment
- **Strategic window now open** — Brokerages implementing governance ahead of lender demands gain competitive advantage

2. Regulatory History

Guideline E-23 represents nearly four years of regulatory development. The timeline demonstrates OSFI's deliberate approach and the industry's opportunity to prepare—no institution can claim surprise at these requirements.

Development Timeline

Date	Milestone
May 2022	OSFI signals intent to modernize model risk guidance from 2017 framework
Nov 2023	Draft Guideline E-23 released for public consultation; proposed effective date July 1, 2025
Mar 2024	Public consultation period closes; stakeholder feedback submitted
Sep 11, 2025	Final Guideline E-23 published; transition window begins
May 1, 2027	**Mandatory compliance for all FRFIs**

Key Changes from Draft to Final

OSFI received extensive stakeholder feedback during the consultation period. The final guideline reflects several important changes while maintaining the core framework:

- **Extended timeline:** Compliance date moved from July 1, 2026 to May 1, 2027—a 10-month extension acknowledging implementation complexity
- **Pension plans excluded:** Federally Regulated Pension Plans (FRPPs) removed from scope given alternative industry guidance
- **Enhanced AI/ML guidance:** Additional explainability requirements and self-learning model provisions added throughout lifecycle components
- **Proportionality clarified:** Guideline now explicitly applies on a risk-basis proportional to institution size, strategy, and complexity
- **Model definition unchanged:** Despite stakeholder requests, OSFI retained the intentionally broad definition encompassing AI/ML methods

3. What Guideline E-23 Actually Requires

The Model Definition

The guideline defines a **model** as:

> *"An application of theoretical, empirical, judgmental assumptions or statistical techniques, including AI/ML methods, which processes input data to generate results."*

A model has three distinct components: (1) a data input component including relevant assumptions; (2) a processing component that identifies relationships between inputs; and (3) a result component presenting outputs in a format useful to business lines and control functions.

This definition is critical. When a mortgage agent uses ChatGPT or Claude to draft client communications, analyze deal structures, or generate marketing content, that interaction involves all three components: data input (the prompt with deal information), processing (the LLM's inference), and results (the generated output). Each such interaction may constitute a "micro-model" subject to governance under E-23.

Three Outcomes of Effective MRM

The final guideline is organized around three expected outcomes for effective Model Risk Management:

1. **Outcome 1:** Model risk is well understood and managed across the enterprise
2. **Outcome 2:** Model risk is managed using a risk-based approach
3. **Outcome 3:** Model governance covers the entire model lifecycle

Six Governing Principles

These outcomes are supported by six principles that define how institutions must operationalize model risk management:

Principle	Summary
1.1 Organizational Enablement	Effective reporting structures and proper resourcing enable sound model governance
1.2 MRM Framework	Framework aligns risk-taking activities to strategic objectives and risk appetite
1.3 Use of Models	Models should be appropriate for their business purposes
2.1 Model Identification	Institutions should identify and track all models in use or recently decommissioned
2.2 Model Risk Rating	Institutions should establish a risk rating approach assessing key dimensions of model risk
2.3 Risk Management Intensity	Scope, scale, and intensity of MRM should be commensurate with the risk introduced by the model

Model Lifecycle Components

The guideline requires governance across the entire model lifecycle. Components include:

- **Model Design:** Establishing rationale, ensuring data quality, following development standards
- **Model Review:** Independent assessment of conceptual soundness and performance
- **Model Approval:** Formal authorization based on review findings and risk rating

- **Model Deployment:** Quality and change control processes in production environment
- **Model Monitoring:** Ongoing performance tracking, drift detection, breach management
- **Model Decommission:** Formal retirement with stakeholder notification and documentation retention

4. AI/ML-Specific Provisions

The final guideline includes enhanced provisions specifically addressing artificial intelligence and machine learning models. OSFI acknowledged the rapid growth in AI/ML usage and the unique risks these technologies present.

Explainability Requirements

Explainability requirements are woven throughout the model lifecycle. Institutions must consider the level of transparency and explainability required based on the model's purpose, level of autonomy, regulatory requirements, and potential impact on customers and stakeholders. For AI/ML models—particularly "black box" approaches—this may require alternative controls.

Self-Learning Models

Stakeholders raised concerns about models that continuously learn and adapt. OSFI's response: institutions must establish internal criteria to determine when a self-learning model has "materially changed." This triggers governance processes including potential re-review and re-approval. LLMs, which are updated by their providers and may produce different outputs over time, fall within this consideration.

Black Box Considerations

The final guideline explicitly references "black box" models in several areas but provides no exceptions for their governance. Institutions using third-party AI tools with limited visibility into their inner workings must still demonstrate adequate controls to assess whether the solution produces appropriate responses.

Key AI/ML Provisions Summary

- AI/ML methods explicitly included in model definition
- Explainability requirements scale with model risk and autonomy level
- Self-learning models require material change criteria and monitoring
- Black box models receive no governance exemptions
- Bias and fairness considerations required in model rationale
- Data quality provisions emphasize AI/ML sensitivity to flawed inputs
- Model drift monitoring particularly critical for AI/ML systems

5. Third-Party Flow-Through Mechanics

The guideline's third-party provisions are where mortgage brokerages enter the regulatory picture. While brokerages are not directly subject to OSFI oversight, they operate within a regulatory ecosystem where federally regulated lenders must demonstrate governance over all models they rely upon—including those operated by third parties.

OSFI's Position on Third-Party Models

The final guideline is unequivocal: third-party models receive no reduced expectations. OSFI explicitly states that the MRM framework must cover "models or data sourced from external sources like foreign offices or third-party vendors" pursuant to Guideline B-10 Third-Party Risk Management.

Key positions from OSFI's stakeholder response:

- **No grace period:** OSFI declined to incorporate grace periods for validating third-party model updates after deployment
- **No accommodation for unwilling vendors:** Institutions must ensure adequate documentation from vendors to satisfy MRM needs; OSFI made no revisions to accommodate vendors unwilling to share information
- **Fourth-party responsibility:** If a third party integrates AI from a fourth party (e.g., a broker's software using embedded LLM functionality), the institution must ensure the third-party model review includes those feeder models

The Contractual Flow-Down Mechanism

FRFIs must demonstrate to OSFI that they govern third-party model risk. The practical mechanism for achieving this compliance is contractual: lenders will update broker agreements to require evidence of AI governance. Anticipated contractual requirements include:

- AI usage attestations and acceptable use policies
- Model inventories identifying AI tools used in deal workflows
- Prompt logging and input/output audit trails
- Evidence of PII masking and data protection protocols
- Human validation requirements for AI-assisted outputs
- Audit rights enabling lender review of broker AI practices

Why the Independent Contractor Defense Fails

Brokerages cannot shield themselves by arguing that agents are independent contractors rather than employees:

- **Principal broker liability:** Under provincial rules (FSRA, BCFSA, AMF, RECA), the principal broker signs off that each deal complies with law and policy. Agent AI misuse flows upward.
- **Lender contractual privity:** Funding partners contract with the brokerage, not individual agents. Compliance obligations bind the brokerage entity.
- **E-23's vendor clause:** The guideline makes no distinction between employees and contractors—third-party models are third-party models.

6. Impact Assessment for Mortgage Brokerages

The transition from pre-compliance to post-compliance represents a fundamental shift in how mortgage brokerages must approach AI usage. Understanding this shift is essential for strategic planning.

Current State: The Unregulated Era

Today, most Canadian mortgage brokerages operate with:

- Informal or nonexistent AI usage policies
- Individual agents using personal AI subscriptions (ChatGPT, Claude, Gemini)
- No standardized prompt discipline or data handling procedures
- Minimal documentation of AI-assisted decisions
- Ad-hoc privacy protection measures
- No model inventory or risk assessment
- Limited audit trail capabilities

Future State: The Governed Era (Post-May 2027)

Following E-23 enforcement, brokerages operating with major lenders can expect:

- Contractual requirements for documented AI governance frameworks
- Lender due diligence on broker AI practices
- Required enterprise-grade AI tools (no consumer accounts for business use)
- Prompt logging and audit trail requirements
- Mandatory PII masking protocols with evidence of compliance
- Human validation attestations for AI-assisted work
- Potential exclusion from lender programs for non-compliant brokerages

Risk Assessment

Brokerages that fail to implement adequate AI governance face material risks:

- **Deal velocity risk:** Lenders may delay or decline deals from brokerages unable to demonstrate AI compliance
- **Relationship risk:** Major lenders may restrict or terminate broker relationships based on governance deficiencies
- **Regulatory risk:** Provincial regulators may increase scrutiny of AI practices as E-23 awareness spreads
- **Competitive risk:** Compliant competitors gain preferential lender treatment and faster funding

7. The Negligible Risk Question

A significant addition in the final guideline is the acknowledgment that not all models carry material risk. This creates a pathway for lighter governance treatment of routine AI usage.

OSFI's Position

The guideline states that institutions "may include a risk rating category that implies a negligible level of inherent model risk and therefore exempts such models from the full model lifecycle governance requirements." However, there must be "a robust process to approve and track such exemptions."

When stakeholders asked whether low-risk use cases like ChatGPT for document summarization or marketing emails could be excluded from critical/high-risk model requirements, OSFI responded that institutions are "empowered to make risk-intelligent decisions, based on the application of the model within the organizational context."

Practical Application for Brokerages

This creates a tiered approach for mortgage brokerage AI usage:

Likely Negligible Risk (Lighter Governance)

- General email drafting without client-specific financial information
- Marketing content generation for general audience
- Summarization of publicly available policy documents
- Administrative task assistance (scheduling, formatting)
- General research without deal-specific application

Likely Non-Negligible Risk (Full Governance)

- Drafting client communications containing financial details
- Underwriting note preparation or deal structuring support
- Rate comparisons or product recommendations
- Analysis of borrower financial documents
- Any prompt containing PII or deal-specific information
- Outputs that directly influence credit decisions

Documentation Requirements

Regardless of risk tier, brokerages should document their rationale for categorization. Even negligible-risk use cases should be tracked in a simplified inventory demonstrating that the classification decision was deliberate and reviewed.

8. Compliance Timeline and Milestones

With 17 months until mandatory FRFI compliance, brokerages have a defined window to implement governance frameworks before lenders begin enforcement. The following timeline provides recommended internal milestones.

Recommended Implementation Phases

Phase	Timeframe	Key Activities
Phase 1: Foundation	Jan–Mar 2026	AI policy development, agent training program design, Enterprise account migration planning
Phase 2: Training	Apr–Jun 2026	Network-wide AI Essentials rollout, prompt discipline training, PII masking protocols
Phase 3: Implementation	Jul–Oct 2026	Logging system deployment, model inventory creation, validation protocols
Phase 4: Testing	Nov 2026–Jan 2027	Internal audit, lender pre-certification discussions, gap remediation
Phase 5: Go-Live	Feb–Apr 2027	Full compliance posture, lender attestations, ongoing monitoring
May 1, 2027	**OSFI E-23 Mandatory Compliance Date for FRFIs**	

Lender Action Timeline (Anticipated)

Based on typical regulatory implementation patterns, lender actions toward brokerages are expected to follow this sequence:

- **Q2 2026:** Initial lender communications regarding AI governance expectations
- **Q3 2026:** Updated broker agreements with AI-specific provisions circulated
- **Q4 2026:** Due diligence questionnaires include AI governance questions
- **Q1 2027:** Compliance attestations required for continued program participation
- **Q2 2027+:** Active enforcement—non-compliant brokerages face program restrictions

9. Strategic Recommendations

The following recommendations are designed to position DLCG as Canada's most AI-ready mortgage brokerage network, transforming a compliance requirement into competitive advantage.

Immediate Actions (Q1 2026)

1. **Complete AI Essentials Training Rollout:** Ensure all agents and corporate staff complete foundational AI literacy training covering responsible use, prompt discipline, and E-23 awareness
2. **Establish Enterprise Account Policy:** Mandate enterprise-grade AI tools (Claude Enterprise, ChatGPT Enterprise, Gemini Workspace) for all business use; prohibit consumer accounts for deal-related work
3. **Draft AI Acceptable Use Policy:** Create comprehensive policy covering permitted uses, prohibited uses, PII handling, logging requirements, and validation protocols
4. **Engage Legal Counsel:** Validate interpretation that agent LLM interactions constitute "models" under E-23 for purposes of lender flow-through

Medium-Term Actions (Q2–Q3 2026)

5. **Implement Prompt Logging:** Deploy lightweight logging system capturing AI interactions by deal ID; start with simple Google Sheet or CRM note approach that can scale
6. **Create Model Inventory:** Document all AI tools used across the network with risk tier classifications
7. **Establish Validation Protocols:** Define human review requirements for different AI use case tiers
8. **Proactive Lender Engagement:** Open discussions with major lenders about AI governance expectations; position DLCG as ahead of requirements

Strategic Positioning

This is not merely a compliance exercise. Brokerages that implement robust AI governance before lender enforcement gain:

- **Preferential lender relationships:** Demonstrate reliability and risk management sophistication
- **Faster deal velocity:** Pre-certified AI practices eliminate compliance delays at funding
- **Recruitment advantage:** Agents seeking stable, forward-thinking brokerages gravitate to compliant networks
- **Market positioning:** "Canada's most AI-ready brokerage network" becomes a tangible differentiator

Appendix A: Key Definitions from Final Guideline

The following definitions are reproduced verbatim from OSFI Guideline E-23 (September 11, 2025):

Model

An application of theoretical, empirical, judgmental assumptions or statistical techniques, including AI/ML methods, which processes input data to generate results. A model has three distinct components: (1) data input component that may also include relevant assumptions, (2) processing component that identifies relationships between inputs, and (3) result component that presents outputs in a format that is useful and meaningful to business lines and control functions.

Model Risk

Model risk involves the risk of adverse financial impact (for example, inadequate capital, financial losses, inadequate liquidity, operational, or reputational consequences) arising from the design, development, deployment, and/or use of a model. This is the inherent risk of using a model and refers to the fundamental characteristics of the model and materiality to the institution.

Model Risk Rating

A categorical model risk tier associated with the inherent level of model risk based on quantitative and qualitative criteria reflecting intrinsic model vulnerabilities and materiality of model impacts from usage.

Model Inventory

An institution's system of record for storing key information related to models and serving as a basis for reporting. It contains all models whose inherent risk is determined to be non-negligible to the institution.

Model Lifecycle

The components that define the life of a model. It encompasses all steps for designing, operating, and maintaining a model until it is decommissioned. Model lifecycle components are model design (including model rationale, data, and development), model review, model deployment, model monitoring, and model decommission.

Appendix B: Do's and Don'ts for Mortgage Brokers and Agents

This appendix provides practical guidance for mortgage brokers and agents using AI tools. The guidance is organized by time period to help you build compliant habits now and maintain them after enforcement begins.

Before May 1, 2027: Building Compliant Habits

The transition period is your opportunity to develop AI practices that will become mandatory. Start now to avoid scrambling later.

✓ DO

Upgrade to Enterprise AI accounts Use Claude Enterprise, ChatGPT Enterprise, or Gemini Workspace for all business activities. Enterprise accounts provide audit logs, SSO, SOC 2 compliance, and contractual commitments that your data won't train the model.
Start logging prompts now Create a simple habit: note the date, deal ID, AI tool used, and general purpose in your CRM or a spreadsheet. You don't need sophisticated systems yet—just start building the muscle memory.
Mask PII before prompting Replace real names with [CLIENT], real addresses with [PROPERTY ADDRESS], real income figures with [INCOME]. You can substitute back after receiving the output. This protects your client and creates a clean audit trail.
Validate AI outputs before using them Never send AI-generated content to clients or lenders without reviewing it. Check calculations, verify facts, and ensure the tone matches your professional standards. You remain responsible for everything that goes out under your name.
Learn the difference between low-risk and high-risk AI use General research and marketing drafts are lower risk. Anything involving client financials, deal structuring, or underwriting support requires more care. Know which category your prompt falls into before you hit enter.
Complete your brokerage's AI training Take the AI Essentials program seriously. Understand how LLMs work, what they're good at, and where they fail. This knowledge protects you and your clients.

✗ DON'T

Use free/consumer AI accounts for business Free ChatGPT, free Claude, and similar consumer tools may train on your inputs and lack audit capabilities. When lenders ask for evidence of governed AI use, consumer accounts provide nothing.
Paste unredacted client documents into AI Never upload or paste complete NOAs, T4s, bank statements, or other documents containing PII directly into any AI tool. Extract only the information you need, mask identifying details, then prompt.
Rely on AI for final calculations LLMs can make mathematical errors. Use AI to draft explanations or structure analysis, but always verify numbers with proper calculators or spreadsheets. A wrong GDS/TDS ratio can kill a deal—or worse, get funded and blow up later.
Assume AI outputs are confidential Depending on the platform and your settings, your prompts may be logged, reviewed, or used for improvement. Treat every prompt as potentially discoverable. Would you be comfortable if your lender saw this prompt?
Wait until enforcement to start preparing Lenders will begin asking questions before May 2027. If you're scrambling to build governance while competitors are already compliant, you'll lose deals. The time to build good habits is now.

After May 1, 2027: Operating Under Compliance

Once E-23 enforcement begins, lenders will contractually require evidence of AI governance. These practices become mandatory, not optional.

✓ DO

Maintain complete prompt logs for every deal
For any AI use connected to a mortgage transaction, log: date/time, AI tool and version, deal ID, prompt purpose, and confirmation of human validation. Upload to your deal file within 24 hours.

Follow your brokerage's approved AI tool list
Only use AI tools that appear on your brokerage's approved model inventory. If you want to use a new tool, request it be added through proper channels. Unapproved tools create compliance gaps that affect the entire brokerage.

Use standardized prompt templates for common tasks
Your brokerage will provide templates for frequent use cases (client emails, deal summaries, etc.). Using these templates creates consistency and makes logging easier. Customize the output, not the underlying prompt structure.

Document your validation steps
When you review AI output before use, note what you checked. "Verified rate calculation against lender matrix" or "Confirmed property address matches commitment" creates evidence that a human applied judgment.

Report AI issues immediately
If an AI tool produces obviously wrong output, exhibits strange behavior, or if you discover you've been using an unapproved tool, report it to your principal broker immediately. Early disclosure allows remediation; concealment compounds risk.

Be ready for lender audits
Lenders may request AI usage evidence as part of deal review or periodic audits. Your prompt logs, validation records, and training completion certificates should be readily accessible. Audit readiness is a competitive advantage.

✗ DON'T

Use AI tools outside your brokerage's approved inventory
That cool new AI tool your colleague mentioned? Unless it's on the approved list, don't use it for business. Unauthorized tools aren't just a policy violation—they create ungovernred model risk that flows up to your principal broker and ultimately to lenders.

Skip logging because you're busy
A deal that moves fast without proper logging is a deal that can stall at funding when the lender asks for documentation. Build logging into your workflow—it takes 30 seconds and prevents hours of problems.

Let AI make decisions for you
AI assists; you decide. Never tell a client "the AI says you qualify" or structure a deal based solely on AI recommendation. You hold the license, you carry the E&O insurance, and you bear the professional responsibility.

Share login credentials for Enterprise accounts
Enterprise accounts create individual audit trails. Sharing logins defeats this purpose and makes it impossible to demonstrate who did what. Each agent needs their own account with their own credentials.

Assume compliance is someone else's problem
Your brokerage provides the framework, but you execute it. If you don't follow the protocols, your deals are at risk, your brokerage relationship is at risk, and your lender access is at risk. Compliance is everyone's job.

Delete or alter prompt logs
If something went wrong, deleting the evidence makes it worse. Audit trails must be complete and unaltered. If you made a mistake, document it, report it, and move on. Integrity matters more than perfection.

Quick Reference: The 60-Second AI Compliance Check

Before hitting enter on any business-related AI prompt, run through this mental checklist:

1	**TOOL CHECK:** Am I using an approved Enterprise AI tool?
2	**PII CHECK:** Have I masked all personal and financial identifiers?
3	**PURPOSE CHECK:** Is this a valid business use that I can document?
4	**LOG CHECK:** Will I log this interaction with the deal file?
5	**VALIDATION CHECK:** Will I review the output before using it?

If you can't answer YES to all five questions, stop and fix the gap before proceeding. Sixty seconds of checking now prevents hours of problems later.

— End of Report —

Disclaimer

This report is provided for informational and strategic planning purposes only and does not constitute legal, regulatory, or compliance advice. Readers should consult with qualified legal and compliance professionals before taking any action based on the contents of this document. While reasonable efforts have been made to ensure the accuracy of the information presented as of January 2025, regulatory guidance may evolve and interpretations may vary depending on individual circumstances. The author assumes no liability for decisions made or actions taken based on this report.