

# ODLUM BROWN REPORT

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**ODLUM BROWN**  
Investing for Generations®

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## It's Good to be Big, Boring and Canadian

**As the Canadian banks reported their results for the first quarter of 2023, attention was squarely on the implications of higher interest rates, particularly in real estate lending. Then the failure of Silicon Valley Bank (SVB) cast renewed attention on liquidity and funding risks for the banking sector worldwide. Fortunately, the big six Canadian banks (Royal Bank of Canada, Bank of Montreal, TD Bank, Scotiabank, CIBC and National Bank) operate quite conservatively relative to global peers, which should help them navigate whatever storms come their way.**

### The Canadian Banks are Very Different From SVB

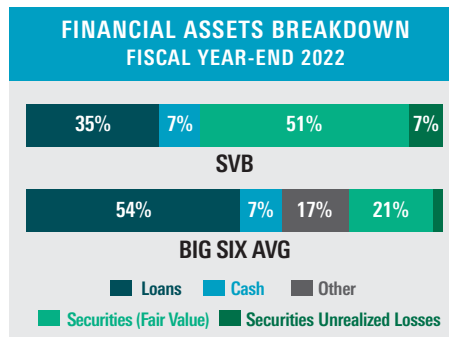
Last month's collapse of SVB came as an absolute shock to the banking community, but the causes of the failure were quite straightforward. The bank's deposits had been declining throughout 2022 as venture capital-backed firms were burning through cash and struggling to raise additional funding. Meanwhile, the bank had a large securities portfolio, which it was forced to sell at a loss to fund deposit outflows. After the bank announced a large securities sale and an equity raise, venture capital firms smelled weakness and frantically encouraged their portfolio companies to withdraw deposits.

The episode shone a spotlight on SVB's securities portfolio, which had significant unrealized losses. Part of these were excluded when calculating total assets but became a serious problem during SVB's final days. Fortunately for the Canadian banks, this dynamic does not exist to nearly the same extent, as they have smaller securities books with minimal unrealized losses.

That being the case, SVB's demise was more a function of its liability profile than its securities portfolio. Because the bank's deposits were heavily concentrated among venture capital-backed firms, there was greater scope for them to behave in a herd mentality. Furthermore, these deposits were almost all ineligible for Federal Deposit Insurance Corporation (FDIC) protection (at the time), so depositors were especially motivated to withdraw their money before losing it. Making matters worse, the vast majority of SVB's deposits were redeemable on short notice.

Conversely, the Canadian banks have very different deposit profiles. They have a much larger weighting toward consumer and term deposits, which drastically lowers the odds of a bank run. A large chunk of those consumer deposits would qualify for Canada Deposit Insurance Corporation (CDIC) protection, which gives depositors additional peace of mind and limits the incentive to withdraw in a panic. Also, the commercial deposits are significantly more diversified by industry and geography, which means clients are unlikely to act with such a herd mentality.

Perhaps most importantly, the Canadian banks are designated as Domestic Systemically Important Banks (D-SIBs), which means they are subject to considerably more stringent capital and liquidity requirements. It also implies that they are



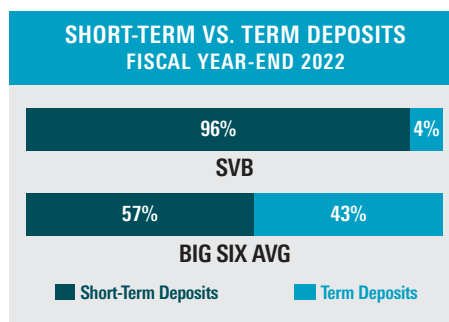
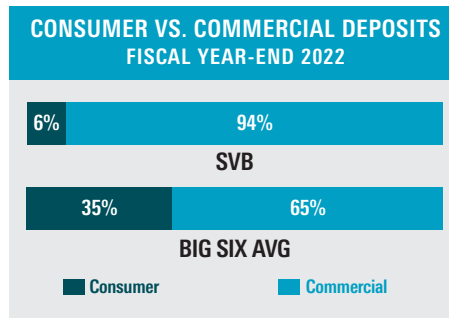
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The pandemic in 2020 and the recent bank failures are reminders of how cyclical the banking industry can be. Yet Canadian bank fundamentals remain strong. All of the big six have enviable market positions, sturdy underlying profitability and ambitious medium-term growth targets.



considered too big to fail. While any government bailout would be costly for shareholders, the implicit government backing should provide a sense of security for depositors and help prevent a repeat of SVB's fate.



### Credit: All Eyes on Real Estate Lending

After eight quarters of improving loan quality, the big six Canadian banks saw their gross impaired loans (GIL) ratio, which measures the proportion of loans unlikely to be paid back fully, increase for the second quarter in a row. This is partly because the GIL ratio was unsustainably low, and notably this number is still well below pre-pandemic levels, and management teams have been repeatedly referring to credit "normalization." Yet it is clear that economic conditions are becoming more ominous, and some borrowers are getting squeezed by higher rates.

The Canadian economy has been buoyed by real estate for decades, and, as a result, Canadians have built up very high debt levels underpinned by strong real estate values. In the past, low interest rates made such debt levels manageable. But in today's environment, more borrowers are coming under strain, particularly those with variable-rate mortgages. A recent CIBC filing revealed that 20% of its mortgage borrowers are seeing their balances grow because the fixed monthly payment is insufficient to cover the variable interest rate. Borrowers with fixed-rate mortgages are better off for the time being but will face higher payments upon renewal. Data released this quarter by BMO, CIBC and NBC indicate that 11-13% of total mortgages will be renewing in the next 12 months.

Despite these worrying trends, the banks anticipate minimal credit losses from residential mortgages. Most residential loans are either insured, made to very high-quality borrowers, well collateralized or a combination thereof. That said, the Canadian banks must not be complacent, nor rely on a strong real estate market to contain credit losses. Any pain experienced by mortgage borrowers could lead to unprecedented losses for mortgage lenders, and there could be knock-on effects for the Canadian economy, which would undoubtedly lead to additional losses in the banks' other loan categories.

### The Big Picture: Compelling Long-Term Investments, but with Cyclicality

The pandemic in 2020 and the recent bank failures are reminders of how cyclical the banking industry can be. Yet Canadian bank fundamentals remain strong. All of the big six have enviable market positions, sturdy underlying profitability and ambitious medium-term growth targets. They generally have solid track records relative to smaller Canadian banks and banks in other countries. Canadian banks deserve credit for their resiliency during the pandemic, and they remain one of the best places to find yield among TSX-listed equities. Economic risks have grown, and we expect some near-term pressure on earnings. Fortunately, the banks are well positioned, both operationally and financially, to weather the economic bumps ahead. Moreover, the recent weakness in the share prices is likely discounting these challenges.



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#### Customary Risk Considerations

Investment risks include: (1) the banks operate economically sensitive businesses and, as such, the strength of the Canadian economy, and other economies where the banks operate will have a material influence on earnings; (2) the banks operate in a competitive industry and increased competition could have a negative influence on earnings, which in turn, would likely have a negative impact on share prices; (3) a sustained decline in equity markets would have a negative impact on operating results; (4) the banks are involved in litigation, which could have a material negative impact on earnings and financial position; and (5) bank share prices are sensitive to changes in interest rates.

# Staying Cyber Safe at Tax Time

At this time of year, many of us are busy gathering documents for tax season – much of which is now done online. As these documents can contain personal and confidential information, this is a good time to remind ourselves to be diligent about cyber security. Here are a few important tips:

- **Think before you click!** Before clicking any link or opening any attachment sent to you by email, take a moment to verify the sender. Were you expecting this document? Is the sender who they say they are? Tax documents from Odlum Brown are provided through your secure Client Centre account at [odlumbrown.com](http://odlumbrown.com) or via mail, depending on your chosen document delivery method.
- **Be wary of providing personal information.** Always verify that a request for personal information, either by phone or email, is legitimate. Odlum Brown will never ask you to provide your username or password over the phone or by email, nor do we accept trades or transfer requests by email.
- **Practice good password hygiene.** Ensure your password is strong and has a minimum of 10 characters, including numbers and special characters. Avoid predictable patterns or common words, and refrain from reusing passwords across multiple accounts. This includes the password to your secure Client Centre account at [odlumbrown.com](http://odlumbrown.com).
- **Protect your personal information offline as well.** Be sure to thoroughly shred documents that may contain confidential information before recycling them.

If you have any questions about how Odlum Brown protects your data, please do not hesitate to contact your Investment Advisor or Portfolio Manager.

For additional resources to enhance your cyber security awareness, please visit [getcybersafe.gc.ca](http://getcybersafe.gc.ca).

ODLUM BROWN FINANCIAL SERVICES LIMITED

## Insurance Solutions for Business Owners

Business ownership takes many forms, including sole proprietorships, partnerships, joint ventures, corporations and self-employment through consulting or contracting. However, all business owners are united in their need to think and plan ahead to ensure that they have the appropriate types of insurance in place to protect their business interests, ownership investment and the people whom they support. We discuss several common uses for insurance below.



### Key person

Very often, businesses are heavily reliant on one or more key persons whose special talents, relationships or experience make them invaluable to the business's success. If such an individual's death or severe illness could seriously disrupt a business's team members, customers, creditors, suppliers, finances, intellectual property or other competitive advantages, then protecting the business with key person coverage is worth considering.

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### Did you know?

We are pleased to offer clients our **2022 Tax Document Guide**, which contains a brief summary of tax filing information and lists the prospective delivery dates of various tax slips and forms.

This guide was enclosed with mailed December client statements and is available under My Documents via your secure Client Centre account at [odlumbrown.com](http://odlumbrown.com).

Key person insurance coverage might include disability, critical illness and/or life insurance for specific individuals. Unlike policies designed as benefits for team members and families, key person insurance is typically structured to pay funds to the business itself for its immediate financial needs and/or to recruit, onboard and retain the replacement skills needed to mitigate the short or long-term impact resulting from the loss of a key person.

**Business loan protection**

Another potential concern is the exposure of a business owner’s personal assets to creditors in the business. Business bankers often require personal guarantees and/or personal collateral for business loans, and an owner’s death or incapacity could trigger loan demands that impact personal assets (or the owner’s estate). This can be problematic. For example, in some cases the call by lenders may occur before the business completes valuable work (e.g., a real estate project).

By planning ahead, business owners may be able to arrange disability and critical illness insurance coverage that can provide cash if a covered health event occurs. The cash could assist with loan payments, income replacement or in some cases even cover the overhead or operating costs of the business. Life insurance could provide additional help as a source of tax-free funds for the business – useful to repay business debts following an insured person’s death.

**Shareholder or partnership agreements**

Often referred to as buy-sell arrangements, such agreements should – but may not always – include clauses that address how a business is to be valued upon certain triggering events, such as an owner or partner’s untimely death, disability or critical illness, and how the subsequent transfer of ownership between parties should be conducted. Problems frequently arise when such agreements have not been formally drafted or executed (e.g., they are unsigned) or when funds to execute the agreement are lacking.

To address this latter concern, insurance products can be a useful source of capital to support fulfilling the agreement as intended if a critical illness, disability or death of an owner or partner occurs. The use of insurance can provide planning predictability for the business, avoid eroding its capital and provide financial support to the owner (or their family or estate) through timely payment for an ownership stake transfer.

**Other purposes**


Business owners may have a variety of other worthwhile uses for disability, critical illness and life insurance. For example, such insurance could provide funds to pay capital gains taxes that may arise upon a business transition, funds for executive compensation plans, or funds to equalize assets being left to other individuals or beneficiaries when a family business is changing hands.

Whether your business is a start-up or at a more mature stage, a well-designed insurance strategy can help both safeguard the money and time that you’ve invested into building your business and help it to fulfill its financial obligations. As well, an effective strategy preserves the legacy you’ve worked hard to achieve.

If you would like more information on the insurance options available through Odlum Brown Financial Services Limited, contact us through your Odlum Brown Investment Advisor or Portfolio Manager.



**RITA AGER, CFP®, CLU, CHS, CPCA, FEA**  
Insurance Specialist  
Odlum Brown Financial Services Limited



**DEBBIE STUART, CLU, CHS, TEP**  
Estate and Insurance Planner  
Odlum Brown Financial Services Limited

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