Weekly Updates Issue # 654

1. Weekly Markets Changes
2. How to make life insurance products better in a rising-rate environment
3. Growth in part-time work behind February jobs gains
4. B.C. residential home sales to dip this year, experts predict
5. CSA proposes national framework for syndicated mortgages
6. Home construction rises in February: CMHC
7. BoC holds key rate, citing U.S. trade uncertainty
8. January trade deficit narrows, but numbers still disappoint
9. Toronto police lay charges in mortgage fraud case
10. Toronto area home sales down 35%, Montreal up 5%

1. Weekly Markets Changes

[March 9, 2018]

S&P TSX	S&P 500	Dow Jones	NASDAQ	CAD/USD	Gold	WTI Crude
15,577.81 +193.2 +1.26%	2,786.57 +39.27 +1.43%	25,335.74 +797.7 +3.25%	7,560.81 +302.9 +4.17%	$0.7757 +0.31c +0.40%	$1,323.93 +1.18 +0.09%	$62.04 +0.79 +1.29%

2. How to make life insurance products better in a rising-rate environment

[March 9, 2018] It seems like the insurance industry has been on a wild ride over the last 10 years: record low interest rates, tax and regulatory changes, the rise of fintech—and we're not done.

This year, insurers are implementing new reserve rules (the Life Insurance Capital Adequacy Test, or LICAT) and planning a full implementation of International Financial Reporting Standards accounting rules by Jan. 1, 2021, which will significantly impact level COI and limited-pay universal life (UL) plans, as well as other similar guaranteed products.

The industry has responded to these changes by introducing new longer-term insurance options such as Term 15, 25 and 30 plans, as well as simplified-issue products. We have also seen a shift toward products with less inherent market volatility, such as whole life.

Effects of fixed income

While we are slowly seeing a rising trend in long-term interest rates, it can take years for a change in benchmark rates to affect insurer crediting rates. In addition, the spread that insurers earn (i.e., the difference between the insurer's investment portfolio and what is credited to the policy) has been

narrowing. Older blocks of business with higher guarantees create greater compression on the spread required for an insurer's new business.
With that said, it's not all bad news when it comes to a rising-rate environment.
Some insurance products credit their returns based on the yield to maturity of their fixed income investments, which is advantageous if the insurer holds bonds to maturity. Therefore, since the bonds are not sold at a discount, there is no loss realized. By creating insurance products that use fixed income in such a manner, insurers can pass on more value to the policyowner over time.
Insurers have been thinking about ways like these to get better yields without creating more uncertainty and risk to the insurer or policyholder. Let's examine a few.
What's a call option?
A call option is a contract that gives the purchaser the right to buy a security from a seller at a certain price on a certain date (called the expiry date). Say you enter into an agreement with a seller for the right to buy 100 shares at a price of $1,000 today. Assume it costs you to $50 to enter into this agreement. On the expiry date, say the market value of 100 shares increases to $1,200. You would then exercise the call option to buy the shares for $1,000, and then sell the same shares on the open market for $1,200, giving you a gross gain of $200 (or a net gain of $150: $200 minus $50). If the market value of the share had decreased from $1,000 to $800, you would not have exercised the call option, but you would have forfeited the $50 transaction cost.

Principal protection with equity upside

Some U.S. insurers are offering principal protection with equity upside on their indexed UL policies. In Canada, this strategy can sometimes be found on indexed annuities, or guaranteed market indexed accounts sold inside Canadian UL policies.
This type of protection is possible because the principal is used to purchase a bond. The insurer then uses the bond's yield to buy call options. The primary advantage of this approach is principal protection with the potential to earn returns that are better than fixed income.
With UL policies, these types of products essentially allow policyowners to protect their net deposits (after insurance charges are deducted) and to potentially earn annual returns that credited to the policy's fund value. Subsequent-year returns are based on the total fund value and the interest credited from the prior year. Therefore, policyowners won't be as exposed to market volatility.

Using options on whole life insurance

Some insurers, mostly in the United States, use options to enhance the investment returns earned on their whole life portfolios instead of depending on fixed income returns. Canadian insurers are starting to introduce this approach. How do these option-based investment strategies compare with a traditional whole life investment strategy?

In a traditional strategy, the insurer typically allocates between 60% and 70% of a given premium to fixed income (after expenses). The remaining 30% to 40% is allocated to non-fixed income investments such as equities. In today's environment, the total annual return on the fixed income portion will currently likely be in the 3% to 4% range. Returns may be smoothed with prior years' returns using a formula. Note that a company's mortality and expense experience is also considered before the company's dividends are distributed to policyowners.

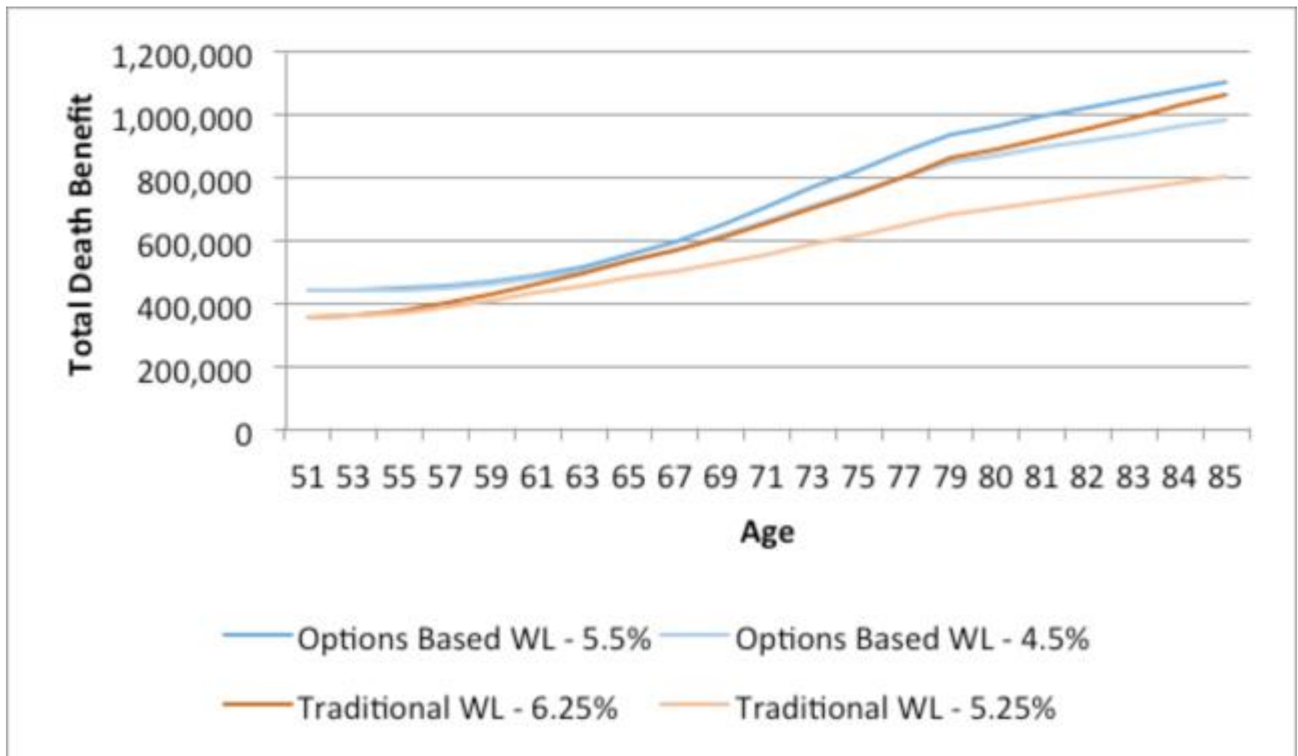
In an options-based whole life investment strategy, the whole premium (after expenses) is allocated to fixed income, thus creating principal protection. Then, 30% to 40% of the total fixed income yield is used to purchase call options. Those options allow the insurer to participate in the upside of the equity markets without risking the principal; in a down market, all the company would forfeit is the cost of the call option.

Diversification using options

An options-based approach allows for greater geographic diversification. Using S&P500 call options, for example, provides greater asset exposure and diversification outside of Canada. Matthew Smith, AVP and pricing actuary at BMO Life Assurance Company, notes that "most whole life products in the Canada marketplace are comprised almost entirely of Canadian fixed income and equities. This lack of diversification outside of Canada can increase the investment risk for the policyholder."

Case study

Let's compare two plans on a 50-year-old male non-smoker. Assume that a policyowner pays a base premium of $25,000 for 10 years on a guaranteed 10 pay whole life plan. The traditional whole life policy has a current dividend rate on its investment portfolio of 6.25%, while the options-based whole life policy offers 5.5%.



Both products provide good value to the policyowner. They project similar long-term values, but the options-based WL plan achieves that value with less volatility.

In light of the slow impact that rising interest rates can have on fixed income portfolios, it's wise to review the impact that lower returns. This is also illustrated on the chart by showing the difference in total death benefit for returns that are 1% less than the company's current dividend scale. As you can see, the gap in death benefit between traditional WL at 6.25% and traditional WL at 5.25% is much wider than the gap between option-based WL at 5.5% versus 4.5%.

3. Growth in part-time work behind February jobs gains

[March 9, 2018] The economy added 15,400 net new jobs last month, and the unemployment rate edged down to 5.8%—but the gains were due to a surge in part-time work that offset a decline in full-time positions.

Statistics Canada's latest labour force survey also says the job gains in February were driven by an increase of 50,300 in public-sector jobs.

Compared with 12 months earlier, the overall job market added 282,500 positions for an increase of 1.5%—and all of that year-over-year growth came from full-time work.

For February the report also found that average hourly wage growth, which has been scrutinized by the Bank of Canada ahead of interest-rate decisions, stayed solid at 3.1%.
Last month's job growth, while small enough to be statistically insignificant, represents an improvement over the January report that showed a drop of 88,000 positions for the labour force's steepest one-month drop in nine years.
The February numbers nudged the unemployment rate down to 5.8% from 5.9% in January.
In a Friday report, Scotiabank's Derek Holt says the jobs results are "certainly not great."
For February, payroll employment went up by 58,800, says Holt. However, all of that gain was in the public sector. And, while "that's not a 'problem' per se in that the public sector-related categories contain many high-quality jobs," he writes, "I would have thought that private sector payroll employment might have rebounded more than it did," compared to January.
Royce Mendes, director and senior economist at CIBC, also says in commentary that the jobs report wasn't exciting. He doesn't expect much market reaction, but says the numbers seem "more indicative of the underlying trend in the labour market than what had been seen in recent months."

4. B.C. residential home sales to dip this year, experts predict

[March 9, 2018] Real estate experts in British Columbia predict residential home sales will dip this year but remain well above the province's 10-year average, although they warn rising interest rates could leave some B.C. households "vulnerable."
The British Columbia Real Estate Association has released its 2018 first quarter housing forecast, showing residential sales are expected to fall 8.6% to 94,855 units this year, with the decline continuing into 2019.
The projected skid follows the 7.5% decrease recorded last year but the association says residential sales in B.C. are still well above the 10-year average of 84,800 units.
Strong employment growth, consumer confidence and more workers moving to B.C. are credited for the booming housing market over the last four years, including 2016, when a record 112,209 homes changed hands.

But the association predicts the pace of sales will cool due to several factors, including a five-year qualifying rate for a mortgage that is forecast to reach 5.70% by the fourth quarter of 2019.
Chief economist Cameron Muir predicts higher interest rates, coupled with slower economic growth, will carry the moderating trend in home sales right through next year.
“More stringent mortgage qualifications and rising interest rates will further erode affordability and household purchasing power,” Muir says in a news release.
The association also notes the supply of homes for sale continues at, or near, decade lows in most B.C. regions, but it says 60,000 new homes are now under construction—well above the 2008 high of 45,000 units.
“Slowing consumer demand combined with a surge in new home completions over the next several quarters will create more balance in the housing market and produce less upward pressure on home prices,” the association says in its release.
It estimates the average price for a home in B.C. is forecast to increase 6% to $752,000 this year, and a further 4% to $781,800 in 2019.

5. CSA proposes national framework for syndicated mortgages

[March 8, 2018] CSA is proposing changes that would harmonize Canada’s regulatory framework for syndicated mortgages.
The proposed amendments, published for comment on Thursday, would remove the prospectus and registration exemptions that currently apply to syndicated mortgages in certain jurisdictions.
“The proposed amendments introduce a common regulatory approach for syndicated mortgages across Canada,” said Louis Morisset, CSA chair and president, and CEO of the Autorité des marchés financiers, in a statement. “The measures also enhance investors’ ability to make informed decisions when purchasing these investments.”
In a backgrounder explaining the changes, the regulatory body says certain jurisdictions have seen “a significant increase” in syndicated mortgages in connection with real estate developments, which can raise investor protection concerns, “particularly when sold to retail investors.”
CSA is proposing revisions to the offering memorandum exemption in order to provide heightened disclosure for investors. “Issuers would be required to deliver property appraisals prepared by an independent, qualified appraiser,” the release says.

The amendment also looks to enhance monitoring of the market by excluding syndicated mortgages from the private issuer exemption. Syndicated mortgages would instead be offered under exemptions "that may be more appropriate for this type of security," the release says, and which generally have reporting requirements.
The changes are reflected in proposed amendments to National Instrument 45-106 Prospectus Exemptions and National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations, as well as changes to Companion Policy 45-106CP Prospectus Exemptions. Read the proposed amendments here. Comments should be submitted in writing by June 6.

6. Home construction rises in February: CMHC

[March 8, 2018] The pace of new home construction picked up in February compared with January, the Canada Mortgage and Housing Corp. said Thursday.
The agency said the seasonally adjusted annual rate increased to 229,737 units in February, up from 215,260 in January.
Economists had expected the rate to come in at 216,600, according to Thomson Reuters. Housing starts are considered a leading indicator—an early sign of how the economy is performing.
The overall increase came as the seasonally adjusted annual rate of urban starts increased by 7.1% in February to 211,211 units.
"Starts likely benefited from the more favourable weather conditions during the month, but are now running ahead of what would be expected given recent readings on building permits," said Royce Mendes, senior economist at CIBC World Markets, in a research note. The seasonal adjustment also tends to boost readings in the winter months, he added.
"As a result, today's consensus-topping reading doesn't do much to change our forecast that residential building activity will cool somewhat in 2018," the note said.
Multiple urban starts increased 15% to 154,535 units while single-detached urban starts fell 9.8% to 56,676 units. Rural starts were estimated at a seasonally adjusted annual rate of 18,526 units.
The six-month moving average of the monthly seasonally adjusted annual rates of housing starts was 225,276 units in February compared with 224,572 in January.
Meanwhile, Statistics Canada reported that municipalities issued $8.4 billion in building permits in January, up 5.6% from December.

The increase was due in large part to permits for multi-family dwellings in Ontario that rose 71% or $404.3 million to $974 million in January, more than offsetting the 39.7% drop reported the previous month.
Overall, residential permits climbed 5.9% for the month to $5.32 billion, while commercial building permits gained 8.9% to $1.7 billion and institutional permits increased 19.2% to $834.9 million.
Permits for industrial buildings fell 18.6% to $554.5 million.

7. BoC holds key rate, citing U.S. trade uncertainty

[March 7, 2018] The Bank of Canada (BoC) today maintained its target for the overnight rate at 1.25%, citing the growing uncertainty around trade. The bank rate is correspondingly 1.5%, and the deposit rate is 1%.
In a press release, the central bank said global growth remains solid and broad-based, and it noted that U.S. government spending and tax cuts are expected to boost that country's growth in 2018 and 2019.
"However, trade policy developments are an important and growing source of uncertainty for the global and Canadian outlooks," said the BoC.
The central bank noted that Canada's GDP was 3% in 2017, which was in line with the bank's projection in its last monetary policy report in January. However, fourth quarter growth was slower than expected, largely due to higher imports.
"The gain in imports mainly reflected stronger business investment, which adds to the economy's capacity," said the BoC.
At the same time, exports made "only a partial recovery" in the fourth quarter, after a decline in Q3.
The central bank also noted softening housing data at the beginning of 2018 in the face of new mortgage rules and other policy measures.
More broadly, the central bank said it "continues to monitor the economy's sensitivity to higher interest rates. Notably, household credit growth has decelerated for three consecutive months."
In an emailed note to clients, Royce Mendes, director and senior economist at CIBC World Markets, described the BoC's announcement as dovish.
"Cooling growth left little reason for central bankers to rush another rate hike," he says. "But U.S. steel and aluminum tariffs sealed the deal."
Mendes says the mention of tighter housing policies and assessment of the effects of past rate hikes also call for a patient approach, "as does the mention that business investment will add to capacity, thereby signalling less pressure on inflation."

The BoC also said the federal budget's effect on growth and inflation will be incorporated into its April projection. And the central bank noted how its core measures of inflation have risen, "consistent with an economy operating near capacity."

Further, fluctuating inflation is due to "temporary factors related to gasoline, electricity and minimum wages," it said.

The central bank also said that, while the economic outlook likely warrants higher interest rates over time, "some continued monetary policy accommodation will likely be needed to keep the economy operating close to potential and inflation on target."

It will continue to remain cautious, and guided by data to assess "the economy's sensitivity to interest rates, the evolution of economic capacity and the dynamics of both wage growth and inflation."

The next scheduled rate announcement is April 18, and will include a monetary policy report.

In emailed commentary to clients, National Bank economists say, "We expect the BoC to remain on the sidelines for another couple of months, by which time there may be more clarity on trade, something that may allow the central bank to raise interest rates two more times later in the year."

Says Mendes: "We're sticking to our call that the BoC only hikes interest rates once more in 2018."

8. January trade deficit narrows, but numbers still disappoint

[March 7, 2018] Canada's trade deficit totalled $1.9 billion in January, a narrowing from December's $3.1 billion deficit, StatsCan reported Wednesday.

That narrowing "was where the good news ended," says CIBC senior economist Andrew Grantham in an economics report, as the deficit was "driven exclusively by a plunge in imports."

Imports decreased 4.3%, mainly due to lower volume of industrial machinery, equipment and parts, reports StatsCan. Exports fell 2.1%, mainly on fewer passenger cars and light trucks.

Grantham notes that export volumes dropped by a "disappointing" 4% to their lowest since June 2016. The drop in exports is "a bad indicator for monthly GDP," he says.

The "soft recent trend in exports, and the greater uncertainty for the future resulting from U.S. tariffs" give reason for the Bank of Canada to "sound

less enthused on the outlook" at its rate decision this morning, Grantham says. The BoC held the overnight rate target at 1.25%.
Notably, nominal imports and exports in January occurred as the loonie gained 2.2 U.S. cents on average relative to the U.S. dollar from December to January, says StatsCan. Import prices fell 0.4%, and export prices grew 1.5%.
"However, import prices were down in nine of 11 commodity sections, while export prices fell in every commodity section except energy products," says StatsCan. "Excluding the price of energy products, which rose sharply in January, the prices of both imports (-1.1%) and exports (-1.8%) fell."
Despite the numbers, "we probably shouldn't read too much into a single month of declines in imports and exports," says Grantham, noting that market reaction was limited after the report was released.
"However, exports have disappointed for a number of months now, and with increased uncertainty for the future due to steel/aluminum tariffs and NAFTA renegotiations, the BoC will be correct in sounding more cautious regarding that part of their forecast and taking it very slowly in moving interest rates higher from here," he says.

9. Toronto police lay charges in mortgage fraud case

[March 6, 2018] A guilty plea from a lawyer who had fled the country gave investigators the information they needed to lay charges against four men in a $17-million alleged mortgage fraud involving high-end Toronto properties, police said Tuesday.
The men, who are all from the Toronto area and between the ages of 45 and 53, face charges including fraud, conspiracy, forgery and money laundering, police said.
Police allege the men took part in a "sophisticated and complex" scheme involving "several high-end properties."
The lawyer's flight from Canada in March 2013 was the reason it took five years to bring charges against the men, said Det. Alan Fazeli.
"She was the lawyer that was registering a lot of these things," Fazeli said. "She was a missing piece."
The lawyer has since pleaded guilty to charges related to facilitating the frauds, he said.
Fazeli said numerous different methods were used in the alleged frauds, many of which involved properties in Toronto's upscale Bridle Path area.

“One of the methods that was used was fake individuals and shell companies had taken mortgages on some of these properties, and for all of them they had produced fake insurance and title insurance,” he said.
Police would not say how many properties were involved in the alleged scheme.
Law Society of Upper Canada documents say the lawyer “participated in a massive fraud spree and multiple dishonest acts involving 13 different properties over a two-year period,” beginning in 2011.
“She prepared and acted upon fake documents in support of other clearly fraudulent transactions,” a Law society hearing document states. “She repeatedly lied to her clients. She gave false testimony before the Deputy Director of Land Titles. Her clients lost just under $14 million as a result of her activities.”
Police said the four men—two from Toronto and two from Richmond Hill, Ont.—were arrested and charged last month.

10. Toronto area home sales down 35%, Montreal up 5%

[March 6, 2018] Canada’s largest real estate board says home sales in the Greater Toronto Area fell nearly 35% year-over-year in February, as selling prices dropped more than 12%.
The Toronto Real Estate Board reported 5,175 residential transactions through TREB’s MLS system last month, down 34.9% compared to the record 7,955 sales reported in February 2017.
The number of new listings entered into TREB’s MLS system in February totalled 10,520, a 7.3% increase compared to the 9,801 new listings entered during the same month last year.
However, the level of new listings remained below average for the month of February for the previous 10 years.
The overall average selling price for February sales was down 12.4% year-over-year to $767,818, but still 12% higher than the average reported for February 2016.
TREB’s 2018 outlook forecasted a slow start to the year compared to the historically high sales count reported in the winter and early spring of 2017.
TREB president Tim Syrianos says prospective buyers are still coming to terms with Ontario’s Fair Housing Plan, as well as new mortgage stress test guidelines from the federal Office of the Superintendent of Financial Institutions.

Meanwhile, 4,081 residential sales were concluded in February 2018 in the Montréal Census Metropolitan Area (CMA). That's a 5% increase compared to February last year, the Greater Montréal Real Estate Board (GMREB) reported.

Sales by geographic area

- Five of the six main areas of the Montréal CMA registered an increase in sales in February, Laval being the sole exception with a 3% decrease.
- The area of Vaudreuil-Soulanges performed especially well with a 21% jump in sales.
- The areas of South Shore (10%), Saint-Jean-sur-Richelieu (7%) and the Island of Montréal (5%) posted significant increases, while the increase in the number of transactions was more modest on the North Shore (2%).

Sales by property

- As was the case in 21 of the past 24 months, condominiums registered the largest increase in sales, jumping by 14%.
- Single-family homes and plexes (two to five dwellings) posted small increases of 1% and 3%, respectively.

Prices

- The median price of single-family homes across the Montréal CMA stood at $310,000 in February, up 6% compared to February 2017.
- The median price of condominiums increased by 5%, as half of all units sold for more than $250,000.
- As for plexes, their median price reached $481,500, a 1% increase compared to February of last year.

"The acceleration in price growth is a direct result of increasingly tighter market conditions, which can be explained by a decline in the supply of properties for sale," says Mathieu Cousineau, president of the GMREB Board of Directors.

Have a nice and fruitful week!

To Unsubscribe Click Here