Weekly Updates Issue # 752

1. Weekly Markets Changes
2. Retail sales flat in December: StatsCan
3. Low-rated corporate bonds are taking up more of the market
4. Plight of the living dead: BoC assesses risks posed by zombie firms
5. DSC ban coming in 2022 as OSC proposes restrictions
6. Inflation rises again, hitting 2.4% in January as tomato prices skyrocket
7. Change to mortgage stress test
8. Advocis officially launches advisor credential
9. Couple charged in connection with CRA scams
10. Corporate leverage at record high, says OECD

1. Weekly Markets Changes

[February 21, 2020]

S&P TSX	S&P 500	Dow Jones	NASDAQ	CAD/USD	Gold	WTI Crude
17,843.53 -4.83 -0.03%	3,337.75 -42.41 -1.25%	28,992.41 -405.67 -1.38%	9,576.59 -154.59 -1.59%	$0.7562 +0.14c +0.19%	$1,643.41 +59.35 +3.75%	$53.46 +1.41 +2.71%

2. Retail sales flat in December: StatsCan

[February 21, 2020] Canadian retail sales were virtually unchanged in December compared with the prior month, ending a year with **the smallest increase in retail sales since 2009 when the country was hit by the financial crisis**, Statistics Canada said Friday.

The flat reading for the final month of the year followed growth of 1.1% in November. Economists on average had expected an increase of 0.1% for December, according to financial markets data firm Refinitiv.

Retail sales for 2019 totalled $615 billion, up 1.6% from 2018.

“This is particularly disappointing in the context of surging population growth seen across Canada this year,” TD Bank economist Omar Abdelrahman wrote in a brief report.

“In terms of growth implications, we maintain our view that the Canadian economy likely hit a standstill in the fourth quarter of last year.”

Abdelrahman said healthy job and wage gains and a recovering housing market should provide a lift to consumer spending, although the sector also faces rising household debt servicing costs.

“Consumer spending is one area that the Bank of Canada has been watching closely and the persistence of recent soft trends **makes a rate cut more likely**.”

The Bank of Canada kept its key interest rate target on hold earlier in January but opened the door to a possible rate cut later this year if the weakness in the economy turns out to be more persistent that expected.

Canadian retail sales in December were up in seven of 11 subsectors, representing 49% of retail trade.

Statistics Canada said sales at building material and garden equipment and supplies dealers rose 3.8% in December, while sales at food and beverage stores gained 0.5%.

Offsetting the gains, sales at motor vehicle and parts dealers fell 1.3% in December, reversing a 2.8% increase in November. Sales at gasoline stations dropped 2.3% in December.

For the full year, retail sales rose in eight of 11 subsectors in 2019.

Sales at motor vehicle and parts dealers were the main contributor to retail sales growth as the sector rose 2.5% in 2019 compared with 0.8% in 2018.

Sales at supermarkets and other grocery stores rose 2.6% in 2019 on higher prices, while sales volumes fell 0.9%. Sales at general merchandise stores rose 3.9% last year.

Statistics Canada said **sales at cannabis stores totalled $1.2 billion** during the first full calendar year of legal marijuana sales.

3. Low-rated corporate bonds are taking up more of the market

[February 21, 2020] The Canadian corporate bond market is increasingly made up of bonds that are rated at the bottom end of investment grade, according to FTSE Russell.

The indexing firm reported that BBB-rated corporate bonds represent a growing share of the corporate bond market. Its index of BBB-rated bonds includes 326 issuers, representing $141.1 million in market cap.

This is equivalent to **29% of the market cap of the FTSE Canada All Corporate Bond Index**. By comparison, back in 2004, BBB-rated issuers represented 14% of the index.

“The past few decades have seen an increase in the proportion of the Canada corporate bond universe with BBB rating,” said Marina Mets, head of Americas fixed income and multi-asset index product management at FTSE Russell.

"Having fixed income benchmarks that accurately and transparently measure this market over time for investors is critical," she added.

BMO Asset Management, Inc. recently introduced new ETFs to track FTSE's BBB bond index and its A+ corporate bond index.

"The changing nature of the Canada fixed income market underscores the need for investors to have strong tools to gain exposure to different market segments," said Mark Raes, head of product at BMO Global Asset Management.

4. Plight of the living dead: BoC assesses risks posed by zombie firms

[February 20, 2020] Canada has a large — and growing — population of so-called "zombie firms," but they aren't likely to pose much of a threat to the financial system, the Bank of Canada finds.

New research from staff of the central bank examined the phenomenon of zombie firms — businesses that have been operating for some time but have trouble generating enough income to cover their interest payments.

In 2018, about 25% of Canadian companies were considered zombies, the Bank found. It also reported that "the share of zombie firms in Canada has been increasing since the mid-1990s."

According to the Bank, Canada has a much higher proportion of moribund companies than other markets. It cited prior research that found that about 12% of companies in advanced economies are zombies.

"The growing share of zombie firms and their relatively large prevalence in Canada is due mainly to firms in commodity industries," the Bank noted.

It said that about two-thirds of the zombie firms in Canada in 2018 were in industries that are exposed to commodity prices.

"The noticeable pickup in the share of zombie firms starting in 2014 is tied to weakness in metal and mineral prices in 2011–12 and then to a broader-based decline in commodity prices in 2014–15," the central bank reported.

The Bank's paper noted that previous studies have found that "zombie" firms lower productivity and economic growth by tying up resources that could be used by more productive firms."

However, it also concluded that Canada's zombies don't pose a significant risk to the financial system.

"We find that **zombie firms account for less than 2% of the overall debt, employment or market capitalization among all Canadian firms**. This implies that defaults by zombie firms would not impose large losses on creditors or shareholders," the Bank said.

5. DSC ban coming in 2022 as OSC proposes restrictions

[February 20, 2020] The Canadian Securities Administrators' (CSA) nearly nationwide ban on deferred sales charge (DSC) mutual funds will take effect in 2022 — except in Ontario, which will instead adopt a series of restrictions on DSC sales.

The CSA's prohibition on fund companies paying upfront sales commissions to dealers will take effect on June 1, 2022 and is expected to result in an end to the DSC funds.

The move is intended to address a series of long-standing investor protection concerns associated with the use of DSCs, including the fact that the structure creates conflicts of interest for dealers, resulting in unsuitable sales, and keeps investors locked into inappropriate funds.

"This decision was motivated by important investor protection concerns," said Louis Morisset, chair of the CSA and president and CEO of the Autorité des marchés financiers (AMF).

"Upfront sales commissions create conflicts of interest and impose liquidity constraints that harm investors. This compensation bias incentivizes dealers to recommend a product that may not be in the best interest of investors and has led to suboptimal investor outcomes."

In Ontario, where the provincial government opposes the CSA's planned ban, the Ontario Securities Commission (OSC) is proposing a series of curbs on DSCs that are intended to reduce the incidence of negative investor outcomes without undertaking a blanket prohibition.

The OSC's planned restrictions include banning DSC sales to investors over age 60, banning the use of leverage in DSC purchases, capping account sizes at $50,000, and banning sales to investors with an investment time horizon that's shorter than a fund's redemption schedule.

The regulator would also limit redemption schedules to three years, require that clients can redeem 10% annually without paying redemption charges, and mandate hardship exemptions.

"The proposed rule is intended to address negative investor outcomes by limiting the circumstances in which mutual funds with the DSC option can be sold and by giving clients greater flexibility to redeem these investments without penalties," the OSC said in a release accompanying its proposed rule.

The OSC's proposals are out for comment until May 21. It envisions adopting the rule on the same timeline as the CSA's ban, with the restrictions taking effect in June 2022.

The CSA said that it considered imposing a series of restrictions on DSC sales as a possible alternative to a ban, but concluded that this approach "only partially mitigated the investor harms we identified and none dealt with the conflicts of interest inherent in the DSC option, or the harmful lock-in feature imposed on investors."

"With ample evidence of investor harm, especially for the most financially vulnerable investors, and no evidence of any benefits, we see no reason to preserve the DSC option," the CSA concluded.

It also noted that industry innovation has improved the industry's capability for serving smaller accounts, which addresses one of the central claims of DSC defenders.

The CSA said that during the two-and-a-half-year transition period, dealers will still be able to sell DSC funds and their redemption schedules will run to their conclusion.

In the meantime, the regulators will also grant relief to dealers from tougher conflict of interest requirements that will take effect under the client focused reforms (CFRs) — which take effect Dec. 31, 2020 — to enable continued use of DSCs until the ban comes into force.

The CSA also noted that it will publish proposals for banning the use of trailer fees by discount brokers later this year. Unlike the DSC ban, that prohibition will be adopted in Ontario, too.

6. Inflation rises again, hitting 2.4% in January as tomato prices skyrocket

[February 19, 2020] Statistics Canada says the annual pace of inflation in Canada jumped 2.4% to start 2020, fuelled by higher costs at the gas pump and pricey tomatoes.

The move compared with a year-over-year increase of 2.2% in December.

Economists had expected a reading of 2.3% for January, according to a poll by financial markets data firm Refinitiv.

Gas prices in January increased 11.2% compared with a year ago as prices rose at the start the month due to concerns about events in the Middle East only to move lower later in the month in response to the novel coronavirus outbreak.

Statistics Canada said Wednesday that excluding gasoline the year-over-year inflation rate would have been 2% in January.

Costs grew for fresh vegetables by 5%, largely attributable the agency says to a 10.8% bump in the price of tomatoes stemming from inclement weather in growing regions of the United States and Mexico.

The overall increase in prices of 2.4% compared with a year ago was also driven by increased mortgage interest costs, purchases of passenger vehicles, auto insurance premiums, and a bump in rents.

The increases were partly offset by lower prices for telephone services, internet access, tuition fees and traveller accommodation.

The average of Canada's three measures for core inflation, which are considered better gauges of underlying price pressures and closely tracked by the Bank of Canada, was 2.033% compared with 2.067% for December.

Regionally, prices on a year-over-year basis rose more in January than December in every province except Ontario and Quebec.

7. Change to mortgage stress test

[February 18, 2020] The federal government is changing the stress test rate **for insured mortgages starting April 6.**

The new minimum qualifying rate will be **the greater of the borrower's contract rate or the weekly median five-year fixed insured mortgage rate from mortgage insurance applications, plus 2%**. (Insured mortgages are those in which the borrower has less than a 20% down payment. They've been subject to the stress test since 2016.)

The minimum qualifying rate is currently the greater of the borrower's contract rate or the Bank of Canada five-year benchmark mortgage rate — which in effect usually means the homebuyer must qualify at the central bank's rate.

That's because the central bank's rate, which is based on the posted rates at the Big Six banks, has typically been about 2% higher than the average five-year fixed contract rate for insured mortgages.

The rate change follows a recent review by federal financial agencies and will allow the minimum qualifying rate to be "more representative of the mortgage rates offered by lenders and more responsive to market conditions," the finance department said in a release.

The Office of the Superintendent of Financial Institutions (OSFI) is considering using the same new stress test rate for uninsured mortgages (those with down payments of 20% or more).

OSFI has been using a minimum qualifying rate of the greater of the lender rate plus 2%, or the five-year benchmark rate published by the Bank of Canada.

OSFI, which is consulting with stakeholders, has proposed that it will also adopt the new benchmark rate on April 6 to coincide with the changes for insured mortgages.

8. Advocis officially launches advisor credential

[February 18, 2020] The Financial Advisors Association of Canada, known as Advocis, has officially launched its Professional Financial Advisor designation (PFA), the association said in a release on Tuesday. The designation is expected to be a potential approved credential as title regulation of "financial advisor" starts to come into force in Ontario and spreads to other provinces.

"Governments are moving forward to protect consumers with regulations that require all financial advisors to hold a valid credential," said Greg Pollock, president and CEO of Advocis, in the release. "The PFA designation will help ensure the quality of advice available to Canadians."

In May 2019, Ontario passed legislation that restricts the use of "financial advisor," "financial planner" and similar titles to those with approved credentials from recognized credentialing bodies.

Saskatchewan tabled similar legislation in December 2019, and other provinces are expected to follow suit.

In Ontario, rules about approved credentials and credentialing bodies are being developed and are expected to come into force at year-end.

Advocis says the new rules will affect a large majority of advisors**. "Three-quarters of licensed or registered advisors do not currently hold a professional designation of any kind,"** Pollock said in the release.

The association's PFA designation was informed by a pilot program initiated in 2018, which attracted more than 350 participants, the release said.

The program's curriculum includes financial planning foundations, taxation and investment planning, and retirement income planning. Candidates also develop practice management skills, including sustaining client relationships, prospecting and marketing, and business planning. Further, the program places a "strong" emphasis on compliance and ethical practices, the release said.

The program can be completed in 24 months, in combination with working full time. It costs $900 for Advocis members, plus an exam fee of $150 (taxes apply to both costs). Non-members pay $1,360 and $350, respectively.

PFA designation holders receive advanced standing for the Chartered Life Underwriter designation program as well as nine of the 12 core curriculum modules within the Advocis Core Curriculum Program for certification as a Qualified Associate Financial Planner and Certified Financial Planner.

Applications for the PFA program are open through March 31, and courses start April 1.

9. Couple charged in connection with CRA scams

[February 18, 2020] Police have charged a Brampton, Ont. couple over their alleged participation in several scams, including Canada Revenue Agency (CRA) scams.

The RCMP announced that they have arrested and charged the couple with one count of fraud over $5,000, one count of money laundering and one count of property obtained by crime in connection with various scams, including **CRA "bank investigator"** and **"tech support"** scams.

The allegations have not been proven.

The arrests follow an investigation by the RCMP's Greater Toronto Area Financial Crime section — code named Project Octavia — that was launched in October 2018 to combat CRA scams.

The RCMP reported that these scams — which involve "callers identifying themselves as CRA and/or…other federal government agencies and then intimidating victims into paying non-existent fines or taxes" — **have cost victims an estimated $16.8 million over the past five years**.

The estimated losses rise to $30 million when similar bank investigator and tech support scams are included.

Along with financial losses, these scams have caused Canadians to become suspicious when the CRA is attempting legitimate contact, police noted.

"The CRA scam, which is operating out of India, has been targeting the Canadian public since 2014, and despite a number of police raids on illegal call centres in India, it continues to victimize Canadians," police said.

The RCMP reported that its investigators have uncovered "money mules and money mule managers" operating in Canada who help launder funds obtained through the CRA scam and other scams.

"Further arrests and charges may be forthcoming as a result of this investigation," it said.

10. Corporate leverage at record high, says OECD

[February 18, 2020] The volume of corporate debt hit record levels at the end of 2019, and the quality of that debt has declined, says the Organization for Economic Cooperation and Development (OECD).

The OECD reported that the value of corporate debt topped US$13.5 trillion at the end of last year, which represented an all-time high in real terms.

The increase in the size of company debt was driven by "the return of more expansionary monetary policies," the OECD said.

Additionally, the organization reported that **the overall quality of corporate debt declined**. For instance, over half (51%) of new investment-grade bonds issued in 2019 were rated BBB — the lowest investment-grade rating, the OECD said.

It further reported that non-investment-grade issuance increased.

"Since 2010, at least 20% of all bond issues have been non-investment grade, and, in 2019, they accounted for 25% of all non-financial corporate bond issues," it said.

The increase in corporate debt is also associated with an increase in repayment obligations.

The OECD reported that, as of the end of 2019, non-financial companies must repay or refinance an "unprecedented" US$4.4-trillion worth of corporate debt within the next three years.

"This represents a record 32.4% of the total outstanding amount of corporate bonds, up from about 25% 10 years ago," it said.

Moreover, given the low interest rate environment, companies have been able to increase their leverage and maintain their credit ratings.

"Today, the median firm in each investment-grade rating is more leveraged than a decade ago," the organization said.

"In comparison to previous credit cycles, today's stock of outstanding corporate bonds has lower overall credit quality, higher payback requirements, longer maturities and inferior investor protection," it said.

The weaker quality of outstanding corporate debt may "amplify the negative effects" of an economic downturn on the economy, it noted.

"The high levels of leverage in the corporate sector now make it essential to put in place reforms that make all parts of capital markets fit for purpose. This must include steps to improve the ability of equity markets to strengthen corporate balance sheets and support long-term investments," said OECD secretary-general, Angel Gurría.

Have a nice and fruitful week!