Manulife

00;00;05;02 - 00;00;26;06
Peter Ward
My name is Peter Ward and welcome to the Solutions to Go podcast. Your source for information on investing, insurance, banking, tax planning and healthy living. If you'd like to know more about anything discussed on this podcast, please visit my Solutions online.ca where you'll find a wide variety of articles and videos.
Today we're talking about something that will be familiar to a lot of us. Debt. Canadians are the most indebted people in the world with an eye popping $1.83 of debt for every dollar earned. Now you can blame inflation. The rising cost of living or the ever more expensive housing market. But this has been a trend on the march since the early nineties.
Today I'm sitting down with David Frazer from Manulife Bank. We're going to find out how we got here and what we might be able to do about it. Welcome to Solutions to Go, David.

00;01;01;19 - 00;01;03;13
David Frazer
Thanks very much. It's good to be here. Thanks for having me.

00;01;03;16 - 00;01;18;08
Peter Ward
So, let's start at the beginning. How did we as Canadians get here? You hear a number like that, and that's just the average. So, some people have way less, but it means that some Canadians may have even more. What are the economic conditions that maybe helped cause this problem?

00;01;18;10 - 00;01;35;26
David Frazer
Yeah, we'll have to do a bit of a history lesson on this one. Go back to maybe 2008, 2009, during the financial crisis. Central banks around the world had to cut interest rates to try and stimulate the economy because of the uncertainty that, you know, took place around the problems that were going on in the markets at the time.
And so we've kind of been living in this artificially depressed interest rate environment since then. At the onset of the pandemic, central banks put further downward pressure. Again, because of the uncertainty in the economy, people didn't know what was going on. Where were consumers going and businesses going to continue to spend. And so, I think Canadians just got used to it.
You know, it's funny to say that it’s a 15 year anomaly, but that's really what it was in, artificially low interest rates. And so, the, you know, consumers that began to form their spending patterns around this low interest rate environment, they got used to cheap money, so to speak. You know, so they didn't really see household debt as an impediment.
They continued to accumulate more and more debt because it didn't cost them a whole ton, an interest rate they could continue to amass more consumer debt, more household debt. And it and it didn't really cost them much and they weren't paying much in the way of interest rate

payments. And so, when you've got a whole bunch of money in debt at 2%, a very different story then a whole bunch of money at 7%, which is maybe closer to today's environment.

00;02;51;28 - 00;03;16;25
Peter Ward
And I often hear some people that are a little bit older than me talk about, you know, interest rates being 18%, 19% on mortgages back in the day. And I think that a lot of people don't have that hindsight. Right? And so that's a really interesting way to look at it. You know, if that's cheap and you see companies do that, too, you know, some companies will issue debt when they could issue common stock, but because it's so cheap, they do that way.
So that makes sense as to the accumulation of the debt, for sure.

00;03;20;20 - 00;03;46;26
David Frazer
Yeah, I I'm in my late forties so I don't remember those days as a borrower at 18 19% interest but I hear stories of it. But yeah, you would obviously make very different purchasing decisions as a business or as a, as a consumer if you're staring down, you know, 16, 17, 18% interest, you know, versus 2%, would you be more akin to refinance a vehicle at two?
You know, absolutely right. And it makes that next consumer purchase that much easier in your mind when, you know, 0% interest rates or 1% interest rates on a large appliance or vehicle purchase. It's you know, it's no mystery why Canadians became so indebted because of that, you know, a very bubbly economy. Things were cruising around quite nicely, but it was all artificially being propped up as a result of the central banks, you know, issuing such cheap debt.

00;04;21;24 - 00;04;44;07
Peter Ward
We talk about that, that big number, the dollar 83 in debt to every dollar earned for Canadians. Does that number and I'm assuming it does include mortgage debt. I know that could be a really large factor in this because the cost of real estate in Canada has been on the rise for a long time. I know it's debt, but it's an asset back that and for most people the value of the property is increased significantly.
Do you see a large mortgage as a worry for most since the asset meanwhile, cover the debt? If they had to sell it and they may end up with a bit of a profit?

00;04;53;00 - 00;05;20;15
David Frazer
Maybe I can answer that in two ways. I can say from a from a banker standpoint, we're not concerned. So, the balance sheet that we manage, we're on solid footing. You know, we monitor these risks on an ongoing basis. So we're not particularly worried about the portfolio. And that and that's in large part because many of our borrowers, many of our customers are sourced through our independent financial advisor network.
You know, they have a sizable investment portfolio. They're typically more astute than the average Canadian or more financially savvy. Now, from the consumer standpoint. Yeah. You know, as you know, only one third of people with fixed rate mortgages today have had to

refinance in the current interest rate environment. So, you know, there's two thirds of people of Canadian mortgage holders who haven't even been affected by the recent interest rate increases.
And so I think there's a bit of a of a reckoning still around the corner for some consumers. They're still holding onto their 2%. You know, five-year mortgage. And, you know, they may not see the true effects of these interest rate increases or this, you know, kind of quantitative tightening, you know, for the months and years ahead.
And I do worry a little bit about, you know, those folks you talked about inflation and, you know, kind of being more expensive these days. And when so much of your, you know, the family budget is now being used to refinance debt. Sure. That's going to have an impact. You know, do you have to pull a kid out of horseback riding lessons? Do you have to let one of the leases in the in the house go? And then eventually you're going to have that desired effect that the government's looking for, which is to reduce some spending or to kind of pull out some of that demand in the economy to effectively bring demand back down, which will result in lower rates.

00;06;48;09 - 00;07;10;25
Peter Ward
And that's a sobering thought that the fact that, you know, it feels like everything's getting more expensive. We have seen all these inflationary pressures, but then two thirds of people with a fixed mortgage maybe haven't even felt the brunt of that. I mean, I don't know what the math is, but, you know, going from a two and a half percent mortgage to a 6% or something or higher could be, you know, a significant chunk of your household income.

00;07;10;26 - 00;07;33;09
David Frazer
That's right. Yeah. We're hearing as much as 30 to 40% rate. So depending on the size of the mortgage, you know, your payment increase because of these interest rate movements by, you know, sometimes 30, 40% and so on, a couple thousand dollar a month mortgage payment, that can be a, you know, a significant change to the way Canadians are spending and how much they're allocating to service their debt.

00;07;33;13 - 00;07;45;05
Peter Ward
Just out of curiosity, do you see the higher rates persisting for longer, like maybe if someone just locked in before the rate started like five years from now, do you think we're going to be higher or lower from here?

00;07;45;08 - 00;08;17;01
David Frazer
Nobody has a crystal ball, of course, but I think what a lot of our advisors are, what we're seeing is a little bit shorter on the curve, meaning I don't think anybody, you know, without a crystal ball is locking in for a typical five year, you know, principal and interest payment anymore because I think the sentiment amongst many borrowers is this is a bit of a temporary measure

by the Bank of Canada to put the brakes on an economy that's otherwise, you know, not spiraling out of control, but overspending rate.
Too many people are too, you know, too many people chasing too few goods and services. And so I think, you know, what most people are saying is they're taking a term that's kind of, you know, middle kind of 2 to 3 year to try and ride out this what they might believe is a bit of a blip in interest rates and then it might settle back down and a little bit more of an equilibrium that's more manageable after that two or three year term is up.
So, yeah, nobody's got a crystal ball. But I think that's where, you know, what we're seeing. Most of the conversations that most of our team is having.

00;08;52;26 - 00;09;18;08
Peter Ward
And so, on the back of that, that's maybe talk about good and bad debt. I always find a way to work my granddad into these podcasts, but my granddad always told me, and he still does not to buy anything I can't afford. Now, obviously this doesn't work for a house or a vehicle, but I found that it works well when it comes to avoiding interest payments on things like a credit card that's maybe talk about the different strategies for using loans and credit cards.

00;09;18;11 - 00;09;37;18
David Frazer
Yeah, like one, the one that comes to mind, you know, as the aging population, a ton of their net worth is tied up in their home. Right? So, they have their paper assets, I'll call it, with their advisor investments, insurance policies. But oftentimes a half of their net worth might be tied up in a in a home. Right.
So call it means nothing to be a millionaire today to have $1,000,000 house. Right. If here in southwestern Ontario or some of the larger Toronto, Vancouver, Montreal markets. And so, a strategy that we often talk about is helping Canadians lead a better life in the pre-retirement or the retirement years by treating that asset their home as a as another tax efficient or tax free means to tap into retirement income.
So, in that in that sense, I'd call that good debt, right? So, to maybe talk that strategy through a little bit more, you have your RRSP investments over the years that you've accumulated with your advisor, you're now converting those into RRIF or retirement income. You might have a small pension from an employer that's converting into a locked in vehicle of some kind.
So, you have these different forms of retirement income, maybe some government supplements CPP, OAS and so on. And you look at all these levers and you decide to start taking money out, your advisor sat down with you and you've orchestrated a payment plan based on your retirement income. But let's say in this environment, the markets are a little unstable, you know, a bit choppy.
And your portfolio happens to be down seven or 8%. And so maybe it's an inopportune time to make a sizable withdrawal from your retirement portfolio. Tax considerations aside, because that might bump you up into another tax bracket. And again, I encourage you to seek out independent advice when it comes to tax matters. Of course. But think about the home is just another forced savings account, right?

So good debt would be, you know, a client who says, I'm going to take out $1,000 of home equity out of the house in the form of a home equity line of credit that might be better for the borrower at the end of the day to do that right? Maybe a taxable withdrawal from a retirement vehicle pushes them up into the next tax bracket.
Maybe. Like I mentioned, their investments are down by 10% and it's not the right time to make a large withdrawal. So, I would say that that's a good strategy that, you know, a lot of advisors are talking to their clients about to give them another lever to pull on to make best use of the tax system and to help clients with a large purchase. If it's a large ticket item, the furnace goes. And you've just retired. Or maybe it's to supplement retirement income at $1,000 a month. If I look at that scenario that that's good debt, right, Peter It's okay to do that because in the end your net worth, which is really what the advisors are doing to help plan for their clients, you're better off at the end of the day. So in that scenario, I think that's a great one. Bad debt. You know, you don't have to be a certified financial planner to say if you're if you're maintaining ongoing balances on a credit card at 30% or 20, whatever it is.

00;12;33;06 - 00;12;53;09
Peter Ward
When it comes to debt and managing it, we don't always have a choice about when or where we spend our money. If the dog gets sick or the family car breaks down and suddenly you find yourself in need of cash. I know a lot of us may be sitting on a huge asset, which is our homes, are there other creative ways and products that will allow Canadians to leverage and access the value in their homes.
Now, I know we just talked a little bit about this, but maybe some other strategies and accessing that value without having to sell their home.

00;13;00;11 - 00;13;29;22
David Frazer
A good way to answer this question, maybe a different way, Peter, is to think about the flexibility or the option to have those over something like rate. And although rate is important when it comes to debt, many Canadians are conditioned to think of rate and rate only where there's a few other factors. Time that comes into play and which is amortization in a lot of cases.
And so, you know, a creative way and maybe I'll help illustrate this in the way of a story. It doesn't answer your question directly. I'm going to come back to it, though. So, we had a client going back to the financial crisis, a manufacturing role, and he and his family, he was the primary breadwinner for the family, great, making great money at a local, uh, they made cars, Right. So, southwestern Ontario, earned an income life was good. Lots of overtime, salary coming into the family was quite nice. Well, because of the financial crisis, it hit the automotive sector particularly hard. The consumer at the time didn't end up going with us, ended up, you know, renewing their mortgage with another bank, a better rate at the time than us, that he was obligated to meet a fixed principal and interest payment every month.
So, because of that, his reduced over time he was down to a modest income rate. The plant was having part time shifts and trying to keep everybody employed, but it burned through a lot of the savings with their advisor. Right? So started to tap into other assets to make up for that

shortfall in, you know, the monthly expenses depleted most of their savings with their advisor throughout the fixed five-year period.

Now, thank goodness by 2013, you know, the economy had started to turn around, overtime was restored and his financial picture improved. But I think that's, you know, kind of a roundabout way to talk about the flexibility of a product like a home equity line of credit, where, you know, the rate was important to that customer at the time, of course, and didn't want to pay more interest than what he had to.
But if you look at the time horizon and the flexibility of a product that allows the consumer to say, maybe I'm not going to put down as much this month because times are a little tight, right? So, if I bring us forward from 2008 until today, you know, we may be on that cliff now right there. A lot of a lot of economists are talking about a recession being around the corner.
You know, when you look at some of the government statistics, with GDP still being up, but if you look at it per capita, it may not be right. We've you know, we welcomed a lot of immigrants into Canada over the last year, year and a half. And so, on a per capita basis, maybe things don't look as robust.
Maybe people aren't spending quite as much. So, to have that flexibility, you know, in in the form of that solution to aggressively pay it when you have the money or pull back on it, regardless of the rate. Another thing, throw rate out the window. But I think that's a more powerful tool in the consumer's hands today over something like, you know, I can get you a 4.92 instead of 5.86 or whatever.

00;16;21;02 - 00;16;39;18
Peter Ward
That's something that people don't often factor in is the time, right? It's like you have a fixed rate mortgage, you have that payment every month, but your financial picture might not be the same month to month. I mean, I'm thinking especially, you know, freelancers or self-employed people who might get lumpy money. You know, they have a big, they might make a big salary, but it might all come at once.
It would be nice to have that flexibility to say, you know, this month, let's just we won't put down as much. But next month when I get, you know, whatever we can, we can do that. And then we have the flexibility to even put more on if we need to so that the flexibility in the product is impressive.

00;16;55;22 - 00;17;14;05
David Frazer
Yeah. And, you know, you look at the consumers at large in Canada, a lot of the banks have prepayment privileges on their fixed rate mortgages, but very few people exercise that privilege and just as you mentioned, the reason for it is they can't ever get the money back. Right. So, if they you know, they come into a windfall.
It was a good month. If they're on a variable income, they're reluctant to make that lump sum against a mortgage because now they've committed it. So, the comfort of knowing that you have access to that money, should your financial situation change. And as you said, Peter, you

know, that's where that flexibility comes in and, you know, rate starts to really take a backseat in, you know, in that scenario because you're saying that's more important to me and my family.

Right? I can survive the economic uncertainty or I can better manage my financial plan with my advisor, knowing that I have that flexibility built in.

00;17;48;17 - 00;18;09;03
Peter Ward
And I look at my own mortgage, it has the prepayment provision in there, too. But I've never once exercised it because if I come into a windfall or something, yeah, like I can put it in there, but then I'll think, well, maybe I could have made more of it by investing or using it for something else or renovated or, you know, so I can, I can understand that hesitation from people to do that.
Right. And instead of this, the fixed payment, then then they have the option. You know, I'll put it in here, you know, it brings down the principal and then if I need it again, we can bring it out. So that's really good.

00;18;21;28 - 00;18;30;11
David Frazer
Precisely.

00;18;30;14 - 00;18;35;20
Peter Ward
So, if we can leave listeners with your top tips on debt management, what would they be?

00;18;35;22 - 00;19;08;18
David Frazer
Yeah, I think I think our advisor network plays a critical role here. I really support independent financial advice and when an advisor has the full perspective on the client's picture, that includes the home, it includes debt, it includes their investments, their insurance, their group plan at work. You can better put together a holistic and comprehensive financial plan because debt and debt repayment might be important.
It might not be right. You know, maybe there's a young member of the family that wants to save for education, and that's a top priority that the advisors, you know, helping the family with. By and large in Canada, nobody owns debt. There's not a there's not an advice provider that has stepped up and said, I'm going to help the consumer base with their debt.
And so that's I think where, you know, us as a supplier come in in concert in working with independent financial advisors to just make that part of the household, you know, balance sheet, right. If you integrate debt into that conversation, I think with the advice from your advisor, you're better off. You know, you can make those trade-offs saying, you know, do I pay down my mortgage this month or do I invest in my RSP?
Right. That's a question that that you see in headlines and in the media a lot. But it's way more nuanced than that. Right. And so, an independent advisor that understands your situation in

detail, that works with us can help make an integrated approach. And they're the ones that are going to give you the best advice on what's right, given your particular situation.

One other maybe in this that I can think of, Peter, is a lot of our studies that we review say that there's a psychological factor in paying off debts one at a time. And it's a bit counterintuitive. The math doesn't actually add up. Conventional wisdom is to pay high interest rate debt down first, right? Yeah. However, where it has played out in reality a little better is because of the psychological win that borrowers feel despite it being a lower interest rate debt.
Let's see, you got a thousand bucks on your credit card and you know something else, like a line of credit that's unsecured or something. If you chip away at that small debt, pay it off all together, you know, cut the card up if you have to, or whatever. People feel empowered to tackle their debt more effectively. And again, the studies have shown it so, you know, you might say, hey, just pay that high interest rate debt down first.
But tackling those wins, eliminating that line off your liabilities helps kind of make you feel better and, you know, challenges you to further reduce other debts. So that that'd be another maybe a tip I'd give Canadians.

00;21;34;18 - 00;21;43;22
Peter Ward
Is that the snowball or the waterfall when we just we just did an article in solutions about the different ways to pay off debt and that was actually what you mentioned.

00;21;43;22 - 00;21;44;21
David Frazer
Oh, no kidding. There you go.

00;21;44;21 - 00;21;56;27
Peter Ward
It is beneficial to do that. But then I think this snowball is like pay off the highest one first because it's like a snowball effect. Right? But the waterfall is kind of like drip on each one or something like that anyway. Right.

00;21;56;27 - 00;22;22;15
David Frazer
But yeah, yeah. It's just, it's, it's the difference between the math and the psychology. I think it's, it's, which is how, you know, many of us make decisions right. Based on, based on sentiment and feeling. And then we use math to justify it after the fact. Right. So, I think that the psychology of a win by eliminating a debt, the studies have shown that that consumers are further ahead as a result.

00;22;22;17 - 00;22;36;00
Peter Ward

And then you could tie that into that to the you know, it's not always about rate discussion, too, because it might feel better to have the flexibility as opposed, you know, with a little bit of a higher rate. It doesn't always mean that the lowest rate product is the best.

00;22;36;02 - 00;23;02;26
David Frazer
One strategy that we use with our advisors. And I don't know whether we coined the phrase or not, but we call it heap and sweep. And so a credit card for many Canadians is a convenient way point of sale terminals or online purchases. But of course, like many carry a high interest rate. And so, what we encourage a lot of people to do is use their credit card interest free throughout the month by using it as their kind of their primary point of sale purchase.
And then through an automated mechanism sweep that across it now sits at the home equity line of credit rate versus, you know, the interest rates that are often associated with credit cards.

00;23;14;22 - 00;23;34;21
Peter Ward
So that's a that's a really good tip for avoiding credit card interest payments, because a lot of people have credit cards for the perks of the points, you know, and they have these really high interest rates. But yeah, you don't want to end up getting, you know, getting the monthly bill with that on there. So that's actually a really good way to make sure if you are paying some interest that it's at a lower rate.

00;23;34;21 - 00;23;36;18
Peter Ward
So I like that, heap and sweep.

00;23;36;21 - 00;23;50;29
David Frazer
Yeah. Peter, it's interesting to note from our debt survey that we do in concert with Ipsos, meaning like bank sponsors it twice a year and you know, surprisingly only 29% of our respondents have a written financial plan.

00;23;51;01 - 00;23;51;28
Peter Ward
Really.

00;23;52;00 - 00;24;19;26
David Frazer
And so, you know, when you look at your debt, your households, where the money is going and it doesn't you know, you don't think budget here, right, Because, you know, you hear that word and it can be tough for people to bite off. But simply writing your intentions down with your advisor, Our studies show that people have a much better track record of debt repayment and, you know, take those measures in connection with their investment and their insurance plans.

And so if there were a tip that I could maybe provide is that write something down, write them, speak to your advisor and put a little plan in place. It doesn't need to be a 20 page document. It can kind of be on the back of a napkin, you know, because so few Canadians actually put their intentions in writing.
I think doing so would help set you on the right path, you know, in concert with your advisors advice.

00;24;41;04 - 00;25;03;26
Peter Ward
Yeah, absolutely. And I think that's important. It feels like it's not official until you write something down, even a grocery list. Right? I can't remember what I needed the store to. They write it down. So that's important. And then I also feel that the advisors almost that that stop gap in a way that you know, you do you talk to them, you make a plan and then you're more likely to stick to it because you have those check ins, they ask how you're doing, things like that. So that's putting some structure around. It is definitely important. So, thanks so much. For being a part of the show and I hope you'll come back soon.

00;25;11;09 - 00;25;20;08
David Frazer
Yeah, absolutely. It's great to be here. Thank you again.

00;25;20;10 - 00;25;48;25
Peter Ward