

# CANADIAN BANK DIVIDENDS: Income Importance During & Beyond the Pandemic

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**Authors:** James K. Stewart, *Executive in Residence, Global Risk Institute*  
Jacqueline Beaurivage



## INTRODUCTION

As Canada's economy emerges in phased and uneven fashion from its historic economic contraction in 1H2020, sustaining household income is of paramount importance in limiting the impacts of the deep recession and in fostering the recovery. In these extraordinary times, Canadian bank dividends have had and will continue to have an increasing role in supporting consumer liquidity and spending, and thus demand overall in Canada.

This article explores the benefits of Canadian bank dividends, beginning with two areas that are often too little recognized. The first is the significance of Canadian bank dividends to sustaining household cash flow and liquidity, including their rising share of retail investor incomes, attractive absolute and relative yields, and dependability. The second is the crucial role of bank dividends in seniors' incomes, including the structural trends boosting their importance in funding retirees' spending needs. The article concludes with a brief examination supporting the dividend dependability of the Canada's six largest banks (the "big six"), underscoring that while they are not "recession-proof", they are highly "recession-resistant".<sup>1</sup>

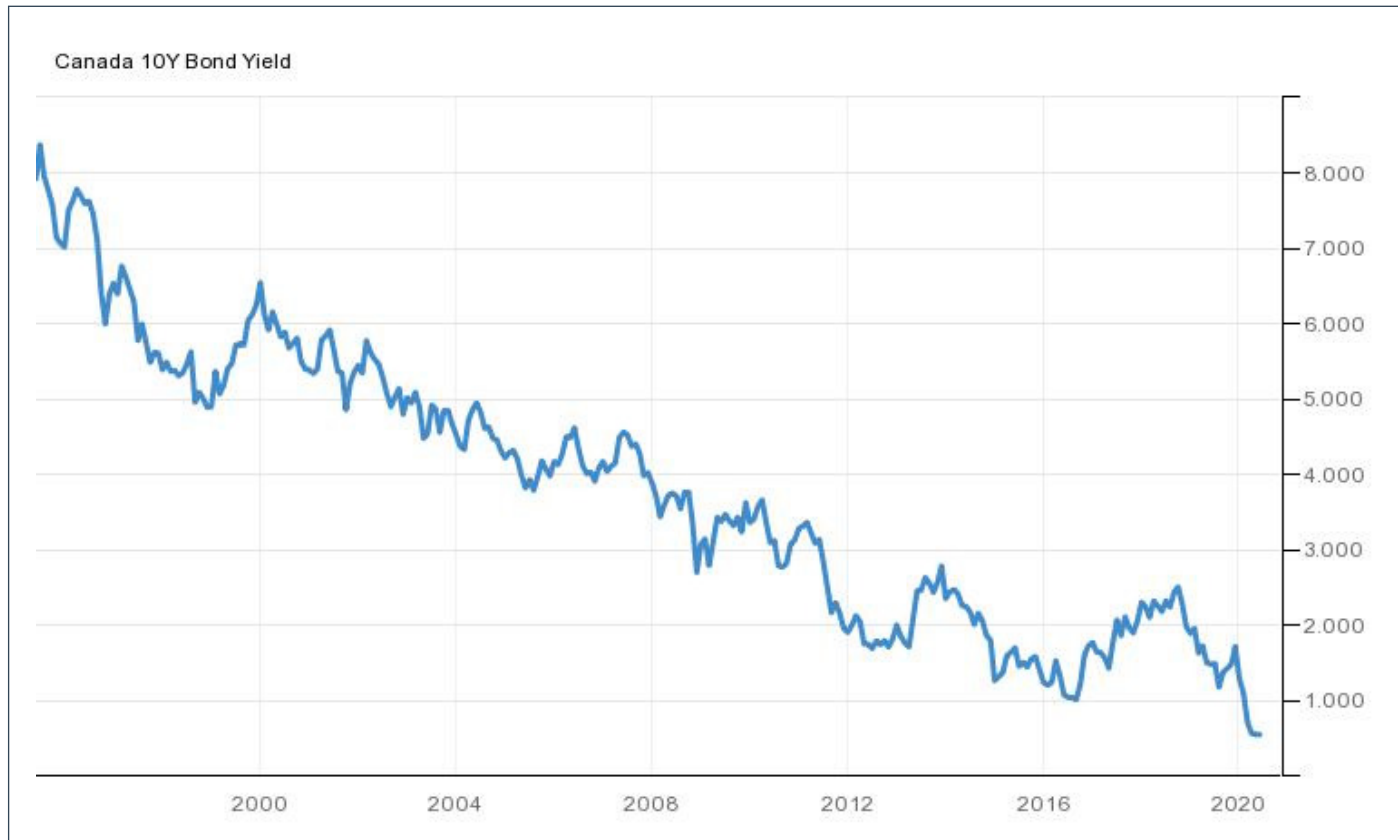
## 1. INCOME IMPORTANCE FOR RETAIL INVESTORS

Providing dependable income support and mitigating other income losses during the pandemic have been crucial to cushioning the severity of the recession.<sup>2</sup> With so many Canadian households' cash flows and earnings hurt by the steep economic contraction, sources of liquidity and income stability beyond government emergency measures have been vital to sustaining consumer spending during the current deep recession and in fostering the recovery.

Estimates are that 40%-50% of bank shareholders are retail investors.<sup>3</sup> Holdings of Canadian bank shares directly provide over a third of all Canadian dividend income received by individual retail investors.<sup>4</sup> Indirectly, Canadian banks also loom very large given the significant amount of Canadian retirement savings in balanced and dividend mutual funds and in ETFs that are "substantially overweight bank stocks as well".<sup>5</sup>

### Increasing Significance and Improved Relative Attractiveness

The importance of Canadian bank dividends has grown substantially with the ultra-low yields on government bonds since the global financial crisis (GFC). Like the financial markets in many other advanced economies, Canada has offered few options for high-quality, higher-yielding securities for over a decade now. Sustained modest interest rates on Government of Canada and provincial government debt have precluded the traditional safe, attractive income opportunity of Canadian public sector bonds prior to 2008 (see Figure 1 below).

**Figure 1: Government of Canada 10-Year Bond Yields<sup>6</sup>**

Source: TRADINGECONOMICS.COM

In 1H2020, public sector bond yields have fallen much further with the reduction in the Bank of Canada (BoC) and the US Federal Reserve System lending rates to near zero, and the enormous quantitative easing of both central banks. While beneficial to businesses seeking funding and in helping reduce mortgage rates, the return repercussions for investors of this year's plunge in yields are substantial. Government bonds continue to be sources of protection of principal at maturity<sup>7</sup> and of liquidity for retail investors, but their yields after adjusting for inflation and taxes fell even further into negative territory to date in 2020.

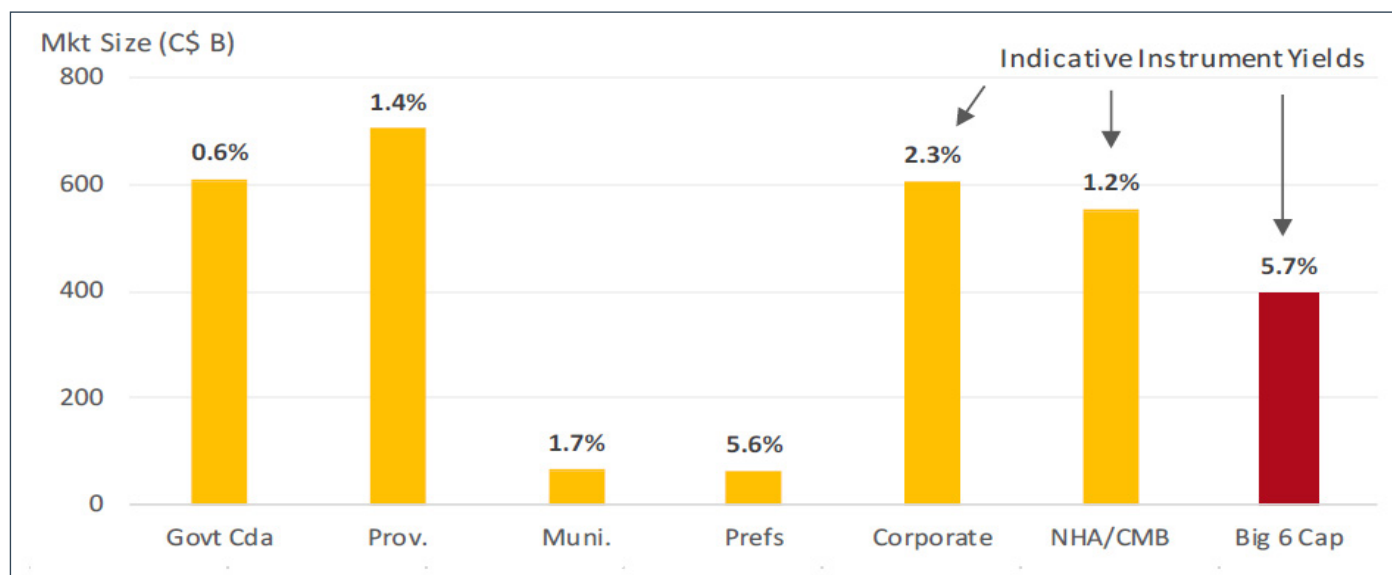
Among the few other options for higher-yielding securities for retail investors are preferred shares, but this market is a small fraction of the total equity market value of Canada's big six banks (Royal Bank of Canada, Toronto Dominion Bank, Bank of Nova Scotia, Bank of Montreal, Canadian Imperial Bank of Commerce and National Bank of Canada). In recent years, preferred shares have also had significant

price weakness at times in the rate-reset component of this market.

Not surprisingly, the common share dividends of Canada's big six are among the most important high-quality payment streams that consistently and materially exceed inflation on a tax-adjusted basis in Canada. As Figure 2 illustrates, the combined equity market size of the big six banks was around \$400 billion on March 31, 2020 with an average yield of 5.7%. Despite the market rollercoaster during much of 1H2020, the big six banks' total equity exceeded \$420 billion in mid June, and offered an average yield of 5.4%.<sup>8</sup>

As Table 1 below illustrates, the big six banks paid out 36.2% of all TSX/S&P dividends disbursed to retail investors, and 28.7% of all dividends paid on the exchange as of the end of March 2020.

Figure 2: Size and Yield of Major Components of Canadian Yield Market



Source: CIBC Equity Research, "Canadian Bank Dividends in Times of Stress", March 31, 2020 (yields priced March 31, 2020)

Table 1: S&P/TSX Dividends Paid by GICS Sector and Non-Institutional Ownership

| S&P/TSX Sector         | Market Cap | Dividends Paid | Dividend Yield | Dividends % of TSX | Estimated Retail Ownership | Retail Dividends Paid | Retail Dividends % of TSX |
|------------------------|------------|----------------|----------------|--------------------|----------------------------|-----------------------|---------------------------|
| S&P/TSX Composite      | 2,123,849  | 78,186         | 3.7%           | 100.0%             | 36.9%                      | 28,857                | 100.0%                    |
| S&P/TSX Big Six Banks  | 396,766    | 22,428         | 5.7%           | 28.7%              | 46.6%                      | 10,452                | 36.2%                     |
| Communication Services | 134,933    | 5,982          | 4.4%           | 7.7%               | 37.1%                      | 2,222                 | 7.7%                      |
| Consumer Discretionary | 84,505     | 1,886          | 2.2%           | 2.4%               | 26.6%                      | 502                   | 1.7%                      |
| Consumer Staples       | 125,169    | 1,888          | 1.5%           | 2.4%               | 54.7%                      | 1,032                 | 3.6%                      |
| Energy                 | 260,093    | 17,802         | 6.8%           | 22.8%              | 29.1%                      | 5,181                 | 18.0%                     |
| Financials             | 627,307    | 32,392         | 5.2%           | 41.4%              | 40.0%                      | 12,959                | 44.9%                     |
| Health Care            | 25,073     | 185            | 0.7%           | 0.2%               | 64.1%                      | 119                   | 0.4%                      |
| Industrials            | 261,739    | 4,193          | 1.6%           | 5.4%               | 23.2%                      | 973                   | 3.4%                      |
| Information Technology | 146,023    | 714            | 0.5%           | 0.9%               | 20.8%                      | 148                   | 0.5%                      |
| Materials              | 237,048    | 3,115          | 1.3%           | 4.0%               | 18.8%                      | 586                   | 2.0%                      |
| Utilities              | 143,362    | 6,373          | 4.4%           | 8.2%               | 52.1%                      | 3,323                 | 11.5%                     |
| Real Estate            | 78,597     | 3,656          | 4.7%           | 4.7%               | 49.5%                      | 1,811                 | 6.3%                      |

Source: CIBC Equity Research, "Canadian Bank Dividends in Times of Stress", March 31, 2020

## Dependability

The consistency of quarterly dividend payments from Canada's big six banks is almost unmatched. The big six banks are viewed as offering growth and attractive yields on a sustained basis, and dependability during challenging economic conditions and difficult financial markets. The big six have sustained dividend levels through the technology, media and telecom bubble of 2000, the GFC of 2007-09, and other very difficult financial markets over the past quarter century. In contrast to the dividend cuts or suspensions in continental Europe, the U.K. and the U.S. during the GFC, the stability of Canada's big six banks was evident as they maintained their dividends.

The dependability of the big six banks' dividends has again stood out during the pandemic. As of May, over 50 Canadian stocks listed on the TSX have cut or suspended their dividends in 2020.<sup>9</sup> Energy sector dividends were already projected to decrease substantially from lower oil prices as the pandemic began.<sup>10</sup> The adverse, volatile oil price trends around much lower average levels in March-April led to more cuts and suspensions in energy sector dividends in 2Q2020. Other TSX-listed entities reducing or postponing dividends to date this year include income funds and real estate investment trusts (REITs). In addition, the uncertain nature and pace of the Canadian and global recovery from the deep 1H2020 recession mean that the potential for a number of other stocks to make similar moves in 2H2020 continues.

According to Statistics Canada, dividends are received by 20% of (i) all Canadian families and (ii) people not in census families.<sup>11</sup> It bears emphasis that the dividend cuts and suspensions of income funds, oil and gas entities, pipelines, and REITs have made retail investors even more reliant upon common bank share dividends in 2020 and likely 2021. The reduced/postponed dividends of other TSX-listed entities have occurred during a time of major declines in incomes for many Canadian households from job losses, reduced working hours and salary cuts.

With Canada's recovery in its initial phase from the severe economic contraction of 1H2020, the role of the big six banks common share dividends continues to be important. Aggregate income from private sector sources was reduced

sharply during the historically deep recession of 1H2020,<sup>12</sup> resulting in the big six banks' dividends making an increased relative contribution among non-government sources of income in support of consumer spending during the recession and in the economic recovery from COVID-19.

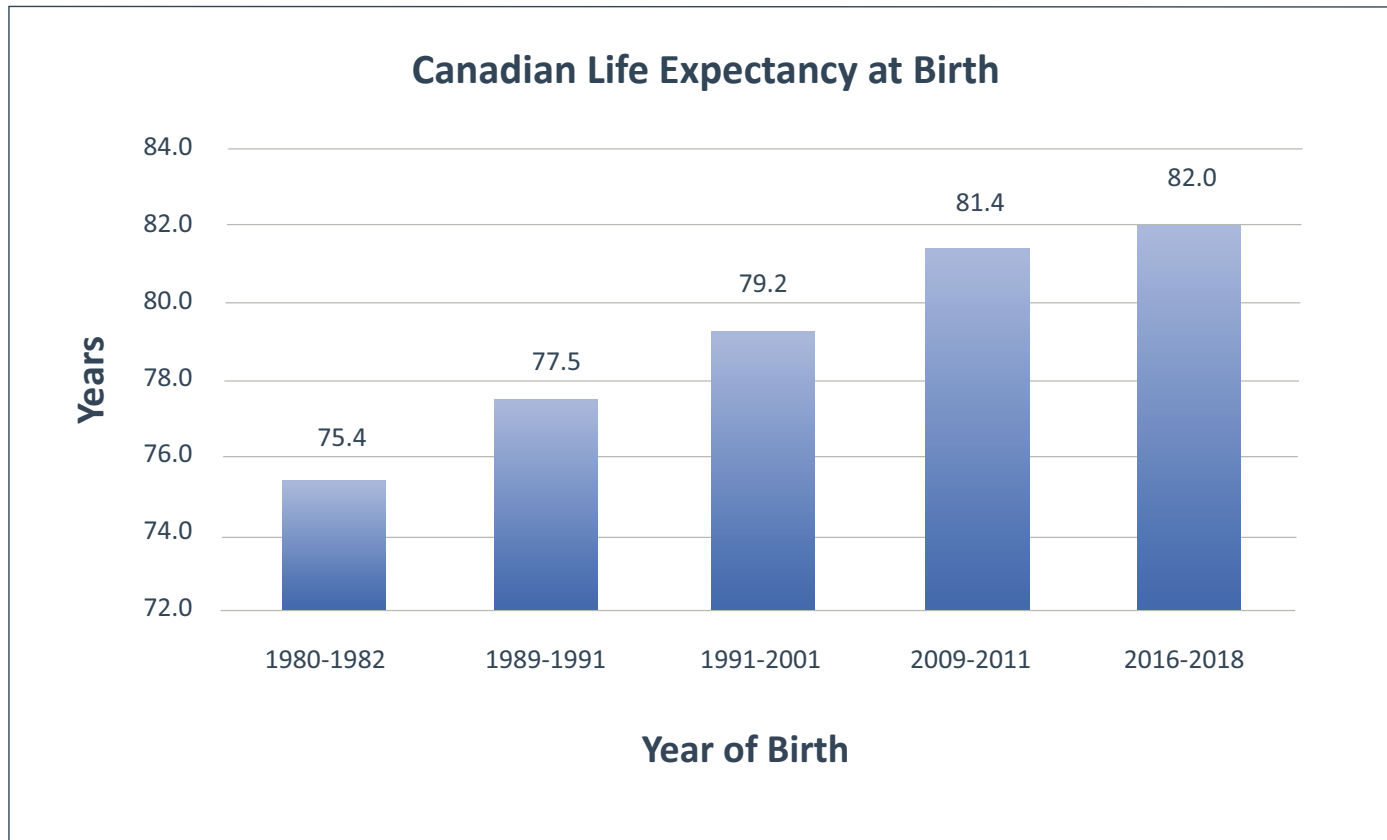
## 2. SENIORS: INCREASING SPENDING NEEDS AND CHANGING SOURCES OF INCOME

From a demographic and economic perspective, the role of investment income in retirement has become much more important for many Canadians in recent decades. In particular, many seniors depend heavily upon bank dividends. As the pandemic began, dividend payments from the big six banks were already estimated to represent one third of all after-tax retirement income for Canadians, either directly in owning bank shares or indirectly through mutual fund holdings, EFTs and pension fund holdings.<sup>13</sup> The contribution of the big six banks' dividends to incomes has also become more significant for seniors in the wake of the cuts and suspensions in 1H2020 noted above by more than 50 other entities on the TSX.

### Greater Spending Needs and Requirements

Secular trends for seniors—longer lifespans, a declining population share with defined benefit pensions, and modest government income support—are boosting bank dividends' significance.

Longer lifespans offer many benefits to Canadians, but they have also led to more income being required for much longer in retirement. As Figure 3 below shows, Canadians' average lifespans have increased from 75 years in the early 1980s to 82 years by 2016-18. An individual born today who will retire at 65 will on average now require retirement income for 17 years versus needing income on average for a decade 35 years ago.

**Figure 3: Increasing Lifespans of Canadians<sup>14</sup>**

Source: Statistics Canada

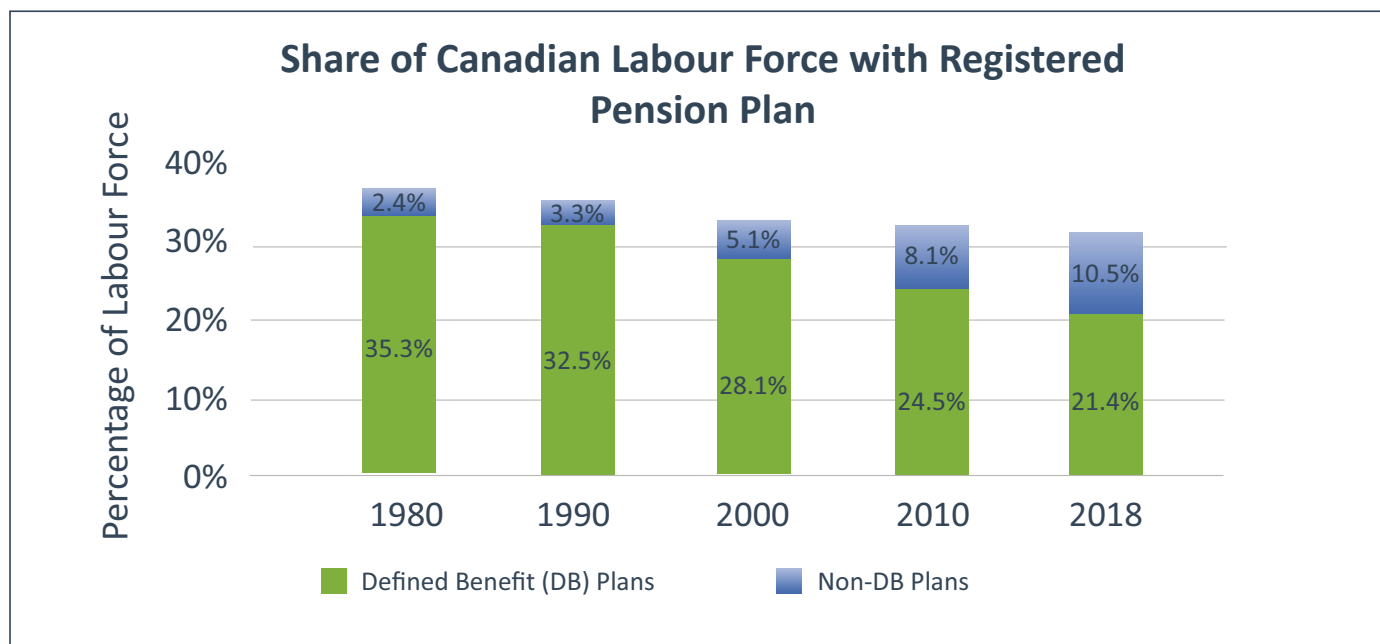
The declining share of Canadians with pension plans, especially the plunge in those that have “defined benefit” (DB) pension plans—employer-sponsored pension plans with specific payouts and benefits beginning in retirement based on an employee’s salary and employment history—is also significant as Figure 4 below shows.

The overall total share of workers with registered pension plans declined from 38% in 1980 to 32% in 2018. Especially noteworthy was the plunge in the share of Canada’s labour force with DB pension plans—from 35% in 1980, DB pension plans fell to 21% by 2018.

While non-DB registered pension plans—including defined contribution (DC) pension plans—have increased their share of labour force members to 10.5%, the differences<sup>15</sup> in the (i) length of time and amount of income payments and benefits, and (ii) greater certainty merit emphasis.

DB pension plans’ retirement payouts and benefits are set out in advance. DB plan members can estimate their monthly income and benefits based upon the DB plan’s obligations, and know that these payments will be received throughout their retirement.

In contrast, while non-DB pension plans now comprise a substantial share of the labour force’s pension plans, they do not offer the same certainty in terms of the (i) amount of income and benefits and (i) period of payout upon retirement. For example, DC pension plans’ retirement income will depend on various factors such as investment returns, and interest rates.

**Figure 4: Declining Share of Canadian Workers with Defined Benefit Plans<sup>16</sup>**

Source: Statistics Canada

Considering these lifespan and pension trends for seniors provides context for looking at the sources of retirement income for Canadian seniors. For the purposes of illustration, a 2018 national survey regarding investment of more than 2,000 Canadian participants—whose composition reflected Canada’s adult population aged 18 and over, and included a wide range of incomes and investment holdings (including none)—is instructive in this regard.<sup>17</sup>

This national survey asked its 681 “retiree” participants about their three largest sources of monthly income.<sup>18</sup> The top-ranked monthly income source selected by 78% of these retirees was “government benefits”—e.g., Canada Pension Plan (CPP), Old Age Security (OAS). The second highest choice was “A pension from an organization where you or your spouse worked” at 59%.

The dependence upon government benefits is notable given the low absolute cap on the maximum OAS and CPP annual payment amounts at \$7,363 and \$14,110, respectively, for an individual at age 65 in mid 2020.<sup>19</sup> The challenges of relying extensively on this direct government income support are evident in the context of the increasing cost of living to seniors. Shelter costs, especially in major urban areas, and medical expenses are both rising faster than the Consumer Price Index used for

inflation increases in OAS and CPP payments. The decline in the share of pension plan members in Canada’s labour force, especially the large decrease in the share with DB plans, is another notable vulnerability given pension income’s role for retirees.

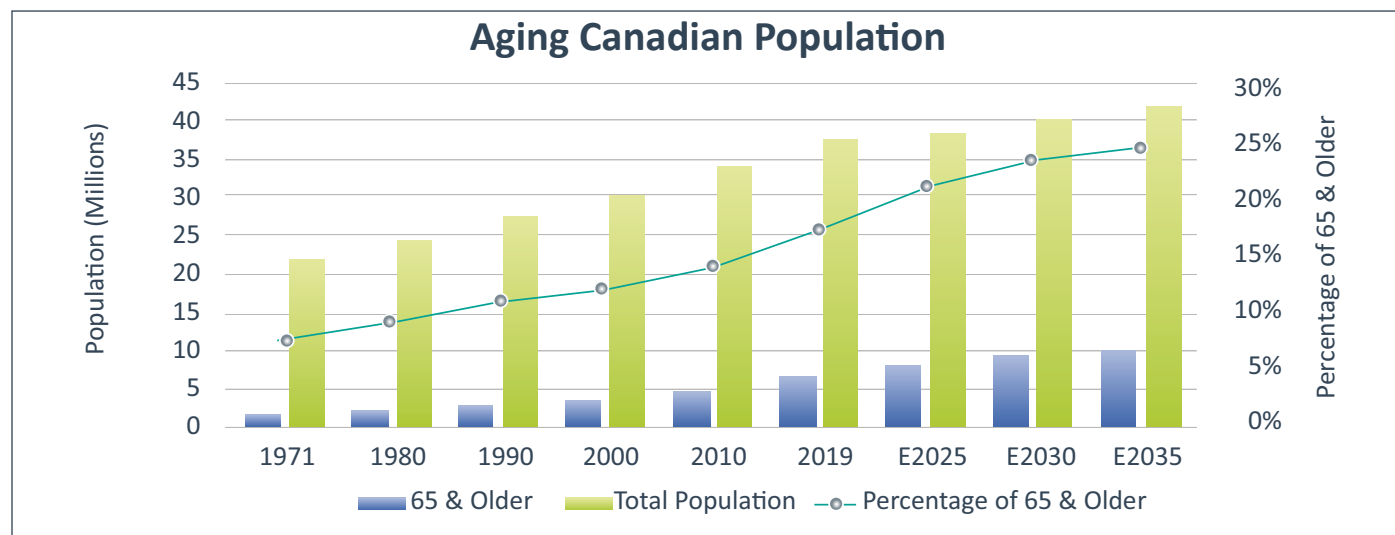
The importance of investment income generally, and the big six bank dividends specifically, is evident in the other top three source of monthly cash flows cited by seniors in this 2018 study. Investment income was identified by 47% of the retirees as one of their top three sources of monthly income, including 28% ranking investment income as their largest or 2<sup>nd</sup> largest source of income.<sup>20</sup>

Looking ahead, the reality of increasing life spans, changes in the shares of the labour force with pension plans, and the limitations of relying upon OAS and CPP payments will be amplified by the rising absolute number of retirees and their increasing share of Canada’s population.

As Figure 5 highlights, the number of Canadians aged 65 and older rose to 6.6 million in 2019 and accounted for 17.5% of Canada’s population, nearly doubling their 9.1% share of Canada’s population in 1980. By 2030, Statistics Canada projects that there will be 9.4 million people aged 65 and older, representing 24.3% of Canada’s population.



Figure 5: Increasing Share of Seniors in Canada's Population<sup>21</sup>



Source: Statistics Canada

### 3. BANK DIVIDEND SUSTAINABILITY

In underscoring the dividend dependability of the big six banks earlier in this paper, it is important to recognize the unprecedented nature of the pandemic's health and economic risks as well as the changed regulatory environment for Canadian banks. Among the alterations in the post-GFC framework for Canada's banking regulation is the potential for dividends to be cut or suspended if a bank's capital falls below certain specified minimum capital thresholds.

Accordingly, while a detailed examination of the sustainability of bank dividends during the pandemic is well beyond the scope of this paper, a concise exploration is merited. This section looks briefly at the two cornerstones of the big six banks' dividend dependability, namely their profitability and capital levels.

#### Profitability

The first building block of bank capital is strong core profitability. High earnings ratios allow banks to better absorb economic shocks and to sustain their capital base. Canada's big six banks have been well described as having high structural profitability that allows them to absorb loan loss pressure and acts as "a buffering system for economic stress".<sup>22</sup>

Given their profitability strengths, analysts expected the big six banks to weather the historically deep recession in 1H2020. Indeed, prior to these banks' earnings reports during the depth of the recession, various analysts characterized their risks as an earnings problem, and thus much more of "an income statement issue than a balance sheet one".<sup>23</sup> The big six banks' net income was expected to decline sharply, but their capital would continue to be sufficient.

The initial quarterly financial results of the Big Six banks during the pandemic were consistent with these earlier assessments. Their earnings in fiscal 2Q2020 plunged, with declines ranging from 32% to 71%. This was driven by the expected surge in Provision for Credit Losses (PCL). In total, the big six banks increased their PCL by \$11 billion. Yet, their net income was almost \$6 billion during a time of a surging PCL, a jump in households and businesses deferring debt payments, and significant interest rate relief measures by the banks. The big six banks' return on equity was positive, averaging 7% during a recession of historic proportions.

Despite the big six banks weathering the pandemic's effects to date in 2020, there is uncertainty in mid 2020 about the durability and strength of the overall economic recovery and the repercussions for bank lending exposure to the oil and gas sector as well as various industries hit hard by COVID-19.

## Capital Strengths

Given these risks to profitability, the big six banks' capital positions are critical to sustaining their dividend payouts. Notably, their capital strengths are also a source of dependability.

The big six banks' longstanding capital strengths begin with their regulatory capital requirements. These six banks are designated as Domestic Systemically Important Banks (D-SIBs) by Canada's Office of the Superintendent of Financial Institutions (OSFI).<sup>24</sup> OSFI's regulatory framework for banks includes its required minimum capital ratios, the most important of which is the Common Equity Tier 1 (CET1) currently set at 9.0% for D-SIBs.<sup>25</sup> For the big six banks, this regulatory threshold of a 9.0% minimum CET1 level, if breached, would result in dividend reductions to enable them to continue to provide crucial lending and liquidity to households and businesses.

Prior to the COVID-19 crisis, the big six banks had an average CET1 ratio of close to 12% versus sub-8% during the GFC.<sup>26</sup> Despite the jump in their PCL in the first quarter of the pandemic, their robust capital bases meant that their CET1 ratios were only reduced to a range of 10.9 - 11.7%, for an average CET1 ratio of 11.2%. Their capital levels in 1H2020 are well above OSFI's 9.0% minimum CET1 ratio.

For its part, the BoC's assessment of the big six banks potential to withstand the pandemic's severe economic and financial stresses is instructive. Based on its staff's rigorous stress tests, the BoC's May 2020 Financial System Review concluded that "The six largest banks entered the COVID-19 period with strong capital and liquidity buffers, a diversified asset base, the capacity to generate income and the protection of a robust mortgage insurance system. The Canadian economy was also in a solid position before the onset of COVID-19. With these strengths, as well as the aggressive government policy response to the pandemic, the largest banks are in a good position to manage the consequences."<sup>27</sup>

## CONCLUSION

The importance and dependability of Canada's big six banks' dividends for households warrant emphasis in supporting consumer spending and liquidity during the pandemic-driven recession and in the recovery. Their growing share of retail investor incomes in the wake of dividend cuts or suspensions elsewhere has been key. The large and rising significance for seniors' incomes is clear, especially given the fundamental trends of longer lifespans, the declining share of the population with defined benefit plans, and the substantially increasing number of Canadian retirees.

The profitability and capital strengths of Canada's big six banks support the dependability and growing role of their dividends in Canadian household incomes. While not "crisis-proof", their robust "crisis-resistance"<sup>28</sup> merits reiteration given the pandemic's unprecedented health and economic risks and uncertainties.

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## ENDNOTES

1. CIBC Equity Research, “Canadian Bank Dividends in Times of Stress”, March 31, 2020, p. 1.
2. The importance of income losses and income support was highlighted by the BoC in its Introduction to the May 2020 *Financial System Review*, “Demand effects are rooted in income losses and uncertainty about just how bad things could get...Government support for households and firms is directly mitigating income losses.”  
<https://www.bankofcanada.ca/2020/05/financial-system-review-2020/>
3. RBC Capital Markets, “Dividend Sustainability in Canada”, March 30, 2020, p. 3.
4. CIBC Equity Research, “Canadian Bank Dividends in Times of Stress”, March 31, 2020, pp. 4-5.
5. *Ibid*, p. 5.
6. <https://tradingeconomics.com/canada/government-bond-yield>
7. Changes in market interest rates after a government bond has been issued will, of course, change the market price of this debt. For example, if interest rates rise, the price of a Canada or provincial bond will decline. If held to maturity and no default has occurred, however, the principal value is protected. The high quality of Canada and provinces’ debt issuance is reflected in their strong credit ratings. Notably, no province has defaulted in the post-WWII era.
8. Capital and yield levels as of the market close on Friday, June 19. See  
<https://www.theglobeandmail.com/investing/markets/watchlist/>
9. “TSX stocks that have cut dividends since the start of the coronavirus crisis”, *The Globe and Mail*, May 13, 2020.
10. See the analysis and outlook regarding various intermediate and senior oil and gas exploration and production firms as well as oilfields services companies in RBC Capital Markets, “Dividend Sustainability in Canada”, March 30, 2020, pp. 21-22, 25.
11. Statistics Canada, “Census families with dividend and interest income by family type”,  
<https://www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=1110006901>
12. <https://www.bankofcanada.ca/2020/06/living-with-limits-household-behaviour-canada-time-covid-19/>
13. CIBC Equity Research, “Canadian Bank Dividends in Times of Stress,” March 31, 2020, p. 1.
14. Statistics Canada, “Life Tables, Canada, Provinces and Territories, 1980/82 to 2016/18”  
<https://www150.statcan.gc.ca/n1/pub/84-537-x/84-537-x2019002-eng.htm>
15. See, for example, Healthcare of Ontario Pension Plan, “The Defined Benefit Difference”,  
<https://hoopp.com/members/become-an-ambassador/defined-contribution-vs-defined-benefit-plans>
16. Data Source: Table: 11-10-0106-01 (formerly CANSIM 280-0016); Labour force data: Table: 14-10-0106-01 (formerly CANSIM 282-0138). Non-DB Plans: DC Plans and Other Plans (hybrid plans, composite and combination plans). See  
<https://www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=1110010601> and <https://www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=1410010601>
17. This Innovative Research Group survey was undertaken to “assess attitudes, behaviour and knowledge among Canadians pertaining to a variety of investment topics, from retirement planning, to conversations about finances, investment decision making.... This survey was conducted online among a sample of 2,259 Canadians, aged 18 years or older in October 2018. Its survey sample was “weighted down to n=2,000 by age, gender and region using the latest Statistics Canada Census data to reflect the actual demographic composition of the adult population aged 18 years or older residing in Canada.” See Innovative Research Group, “National Investor Research Study”,  
[https://www.osc.gov.on.ca/documents/en/Investors/inv\\_research\\_20181128\\_national-study.pdf](https://www.osc.gov.on.ca/documents/en/Investors/inv_research_20181128_national-study.pdf)
18. *Ibid*, p. 43.
19. <https://www.canada.ca/en/services/benefits/publicpensions/cpp/old-age-security/payments.html#tbl1>; and

<https://www.canada.ca/en/services/benefits/publicpensions/cpp/cpp-benefit/amount.html>

20. Innovative Research Group, “National Investor Research Study”, p. 43.
21. Historical data source: <https://www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=1710000501>; Projection source: <https://www12.statcan.gc.ca/census-recensement/2016/dp-pd/pyramid/pyramid.cfm?type=1&geo1=01>
22. CIBC Equity Research, “Canadian Bank Dividends in Times of Stress”, March 31, 2020, pp. 1-2.
23. Scotiabank Equity Research, “Canadian Banks”; March 31, 2020; and the interview of Gerard Cassidy, RBC Capital Markets Head of U.S. Bank Equity Strategy at <https://thoughtleadership.rbc.com/why-the-worlds-biggest-banks-are-stable-in-this-crisis-so-far/>
24. “OSFI has issued orders that legally designate Canada’s six largest banks as Domestic Systemically Important Banks (D-SIBs). The orders also set out their minimum total loss absorbing capacity requirements. This follows the coming into force of legislation that formalized OSFI’s identification of these banks as D-SIBs in March 2013. These changes are part of the Government of Canada’s comprehensive risk management framework for D-SIBs.” See OSFI, “OSFI formally designates Canadian D-SIBs”, August 21, 2018, <https://www.osfi-bsif.gc.ca/Eng/wn-qn/Pages/nr20180821.aspx>
25. The CET1 ratio for D-SIBs is comprised of the 8% capital buffer determined by the Basel III regulatory framework of the Basel Committee on Banking Supervision plus OSFI’s Domestic Stability Buffer (DSB) currently set at 1.0% for D-SIBs. OSFI lowered the DSB from 2.25% to 1.0% on March 13, 2020 as part of a series of regulatory measures to support the six largest Canadian banks’ lending to and liquidity for Canadian businesses and households, and to support these banks’ financial resilience. See [https://www.osfi-bsif.gc.ca/Eng/osfi-bsif/med/Pages/nr\\_20200313.aspx](https://www.osfi-bsif.gc.ca/Eng/osfi-bsif/med/Pages/nr_20200313.aspx)
26. RBC Wealth Management Dominion Securities, “Are Canadian bank dividends sustainable?”, March 2020, p. 2.
27. <https://www.bankofcanada.ca/2020/05/financial-system-review-2020/>
28. CIBC Equity Research, “Canadian Bank Dividends in Times of Stress”, March 31, 2020, pp. 2-4.