New accreditation may lead to growth in use of the 'Smith Manoeuvre'

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The potential wealth-generating power of the Smith Manoeuvre is what investors find attractive as it can create hundreds of thousands of dollars of additional returns over several years. However, the complex leveraged strategy is not without its risks.

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The “Smith Manoeuvre” has been a niche strategy in Canada’s investment industry for decades, but a new training program and accreditation seek to professionalize the leveraged approach and, in turn, increase the number of financial advisors offering it to clients.

Launched last year, the Smith Manoeuvre certified professional (SMCP) accreditation program aims to train not only advisors but also mortgage brokers, accountants, and other financial professionals who often help their clients use the approach of transforming non-tax-deductible mortgage debt into a tax-deductible investment loan.

In short, the strategy involves borrowing against property through a home equity line of credit (HELOC) as the equity increases with each mortgage payment and investing that money in non-registered assets that produce or have the potential to generate income. Thus, the interest costs on the HELOC create a tax deduction, which increases over time, and the associated tax returns can be used to pay down the remaining mortgage on the property and borrow more to invest, presumably further accelerating portfolio growth.

“There are a lot of financial professionals who have been implementing the Smith Manoeuvre successfully for many years, but we’ve also heard many stories … about how people have not been put in it correctly,” says Robinson Smith, president of Smith Consulting Group Ltd. in Victoria, the organization behind the new certification.

Indeed, missteps with the high-risk investment approach can be costly for clients. Yet, advisors also face their own risk: running afoul of regulators.

To Mr. Smith, whose father Fraser Smith “pioneered” the strategy in the 1980s and wrote the best-selling book *The Smith Manoeuvre*, the new SMCP accreditation aims to help advisors avoid pitfalls.

“We want to educate financial professionals so they can guide their clients properly,” thereby increasing the likelihood of the strategy’s success, which ultimately entails accelerating long-term growth of client wealth, he adds.

So far, only a few dozen financial professionals have completed the course, but several more are currently enrolled in the program – although Mr. Smith adds he doesn’t “want thousands of advisors with the designation.”

One reason for its recent popularity is its potential value for millennials as most of their earnings often go toward mortgage payments and they have little cash flow left over for investing.

With the Smith Manoeuvre, these clients "take advantage of compound growth by investing funds [in a non-registered account] that would otherwise not be available without the strategy," says Mr. Smith, who authored the 2019 book *Master Your Mortgage for Financial Freedom: How to Use The Smith Manoeuvre in Canada to Make Your Mortgage Tax-Deductible and Create Wealth*.

The book updates his father's treatise, published almost 20 years ago, for today and includes new twists, such as "accelerators," which use dividends to pay down the mortgage. That, in turn, increases the amount of tax-deductible debt that can be used to invest.

While attractive for millennials, the strategy may be effective for anyone with a mortgage and a long-term investment horizon, says Darren Sweeney, certified financial planner at Wealthy Way Solutions in Waterloo, Ont.

"When I think about clients I've helped implement [the strategy] in the past year, maybe about 20 per cent were existing clients," he says.

Mr. Sweeney read Fraser Smith's book many years ago and has been helping clients use the strategy for about 15 years – and all are pleased with the outcome.

Yet, after recently completing the SMCP course, Mr. Sweeney gained about a dozen new clients specifically interested in the strategy.

"A lot of them heard Robinson [Smith] talk … went to a real estate seminar or heard from a friend … so they started searching it on Google and came across us," Mr. Sweeney says.

The potential wealth-generating power of the Smith Manoeuvre is what attracts clients, and it can create hundreds of thousands of dollars of additional returns over several years, as an example that Mr. Smith shares demonstrates.

For a $500,000-mortgage on a $750,000 home amortized for 25 years at 2.5 per cent interest, the strategy can accrue more than $880,000 in additional wealth, based on a 7 per cent annual return, on a line of credit with 2.95 per cent interest that, in turn, accrues more than $281,000 in tax deductions. As well, the illustration includes two accelerator strategies, a "debt swap" and a "cash-flow dam" that boost returns.

Mr. Smith admits the Smith Manoeuvre can be complicated – at least more than it first appears. That's why training for the SMCP provides value for professionals, helping ensure clients keep accurate records of payments and contributions, invest only in qualified non-registered assets and select the right mortgage to stay onside of interest deductibility rules set out by Canada Revenue Agency.

“One important part of the Smith Manoeuvre is it requires a re-advanceable mortgage,” Mr. Sweeney says. Most financial institutions offer this type of mortgage, which includes a HELOC with a limit that increases along with each mortgage payment.

Yet, the strategy’s complexity is one reason why Ty Cooke, portfolio manager with the Orlic Harding Cooke Wealth Management Group at Richardson Wealth Ltd. in Burlington, Ont., would be leery of using it with many clients.

“If all of the moving parts work as they should … I won’t deny it would work well,” he says.

Mr. Cooke’s concern revolves around whether clients who have experienced a record-long bull market fully grasp the risks of a steep downturn in the stock market and real estate at the same time, along with other factors like job losses and rising interest rates.

“That’s where you have to know the client inside and out,” because, otherwise, advisors risk having upset clients lodge complaints with regulators, who may examine if the strategy was suitable, he says.

The Smith Manoeuvre, like any leveraged strategy, does raise concerns with regulators, including the Investment Industry Regulatory Organization of Canada and the Mutual Fund Dealers Association (MFDA).

In an e-mail to The Globe and Mail, the MFDA cited four enforcement rulings involving advisors found to have recommended the Smith Manoeuvre “or a variation on it” inappropriately in recent years.

The SMCP designation is meant to avoid these occurrences, Mr. Smith says.

“In hindsight, that would have been a valuable … to ensure these professionals were properly trained,” he says.

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