



TD Economics

Commentary

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2007 FEDERAL BUDGET OPENS THE DOOR TO GREATER DEMAND FOR MAPLE BONDS FROM THE RETAIL MARKET

- **Maple bonds are now eligible investments for RRSPs**
- **This could increase retail demand for Maples in future**
- **But issuers would need to meet more stringent regulation requirements**

Amongst the many new spending and tax measures in yesterday's Federal budget was an announcement that could open up new opportunities for Maple bond issuers in the Canadian market. The federal government announced that effective immediately, it would extend Registered Retirement Savings Plan (RRSP) eligibility to include (1) any debt obligation that has an investment grade rating and that is part of a minimum \$25 million issuance and (2) any security (other than a futures contract) that is listed on a designated stock exchange. Under the proposals, the government states "these changes will provide registered plan investors with greater investment choice and diversification by, for example, removing the impediments to investing in ... Canadian dollar bonds issued by foreign entities" – in other words Maple bonds.

Maple bond issuance has already experienced rapid growth since the elimination of the Foreign Property Rule (FPR) in early 2005. However, the market has been virtually restricted to institutional buyers, with roughly 100 major accounts being the buyers of the bonds. Retail investors have been able to benefit from the rapid growth in Maple issuance, but only indirectly through mutual funds or pension funds.

Under the new budget proposals, Maples will become more attractive to retail investors since the bonds can now

be included in RRSPs. However, it will be up to issuers to decide if they want to target individual Canadians. Up to this point, Maple issuers have been able to limit the securities regulation required on their bonds, since they are sold to sophisticated money managers. If the bonds were to be in the retail market, more stringent regulatory requirements would need to be met.

So, how big is the retail market? To be fair, retail purchases of financial assets pale in comparison to institutional buying by pension and investment funds. In 2005, Canadians held \$585 billion in non-pension financial assets and \$593 billion within self directed retirement plans (including RRSPs, LIRAs and RRIFs). Nevertheless, direct holdings of financial assets have been steadily climbing over time. Over the six years ending in 2005, which includes the period of the tech wreck, personal non-pension financial assets have increased 20% and registered plans have increased 26%. Looking forward, the trend is likely to continue. In addition to capital returns and savings inflows, the structural shift away from defined benefit pension plans and the higher opt-out rate on defined contribution plans point to greater direct holding of financial assets by retail investors in the future.

The decision to make Maple bonds RRSP eligible should not be minimized from a retail market perspective. As noted above, RRSPs represent roughly half of personal financial asset holdings and RRSPs will remain an attractive vehicle for many individuals, as the tax rebate can help boost the income available for saving. To illustrate the upside potential of contributions to RRSPs, Statistics Canada estimated that there was \$437 billion in unused RRSP room at the end of 2006. In terms of the asset distribution, more

than half of the funds within self directed retirement plans were held in mutual funds and income trusts in 2005. The remainder was split across term and guaranteed investment certificates (21%), Canadian and foreign publicly traded stocks (10%), government savings bonds (3.9%), and other fixed-income products (14%).

A strong case can be made that the asset mix will change in coming years, which could prove beneficial to Maple bonds. We are in a sustained low inflation, low interest rate environment, which suggests that the quest for any pick up in yield will remain a dominant theme in markets. And, there may be more attraction for fixed income products within RRSPs. Recent changes granting even greater preferential tax treatment of dividends provides less incentive to hold equities within RRSPs. Over time, the as-

set mix within RRSPs should trend towards a greater holding of fixed income products, with additional emphasis on non-federal debt, which could include Maples if issuers make them available to the retail market.

So, Maple bond issuers may find that there are now greater opportunities to sell to individual Canadians, but the added regulatory burden would be an additional cost that needs to be taken into consideration. The increased access to retail investors is unlikely to have a dramatic effect on the overall Maple market, which is expected to remain dominated by strong institutional demand. But, the main point is that Maple issuers have more choice than before and there is likely to be a net increase in demand for Maples in the Canadian marketplace by the proposals in the 2007 budget announcement.

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