

In 2011, Canadian companies and industry sectors experienced a turbulent year marked by international political inertia, sovereign debt concerns, particularly in the European Union, tepid growth and economic uncertainty. In spite of volatility and these prevailing factors, Canadian companies and sectors continued to post impressive results. Here are some of the key trends we expect to drive Canadian capital market performance in 2012.

### **VOLATILITY CONTINUES TO BE THE NEW NORM**

Despite the outlook for the Canadian economy, the current perception of the Canadian capital markets and its regulatory regime, and Canada's recent recognition by *Forbes* magazine as the best country in the world to do business, we expect intervening events that will create global, regional and/or local uncertainty from time to time over the course of 2012. We believe a number of factors will create the potential for market uncertainty leading to increased volatility, including ongoing sovereign debt crises coupled with sluggish growth, international political instability and domestic housing market concerns. In 2012, participants in the Canadian capital markets will have to be prepared for the potential of this increased volatility and have appropriate contingency plans or be able to adapt quickly.

### **IPO AND EQUITY MARKET ACTIVITY AFFECTED BY VOLATILITY**

The Canadian initial public offering (IPO) and equity markets were subject to unprecedented uncertainty and volatility in 2011, and we expect that trend to continue throughout 2012. Extreme volatility weighed heavily in 2011, particularly over the final two quarters, with a number of issuers deferring their market activities until the market fluctuations subsided and stability returned, illustrated by the Canadian IPO market posting just over C\$2-billion equity raised in 2011 – the third-lowest total in the past 10-year period. With volatility creating significant impediments for IPO timing and stability, we have seen a rise in the number of companies utilizing reverse take-overs (RTOs) to access capital markets. 2011 saw an uptick in RTO activity with equity raised via RTOs increasing approximately 20 per cent, and we expect to see more companies turn to RTOs as an alternative to access Canadian public markets as volatility and instability persist. In spite of these factors, total equity capital raised in Canada increased approximately eight per cent in 2011 according to published data.

### **CONTINUED RESOURCE COMPANY ACTIVITY**

With the global demand for resources continuing to be strong (despite some early indications that Chinese and other emerging economies' economic growth may be softening) and prices near record highs, we expect resource-sector activity will continue to be a driver in 2012. New listing activity on the Toronto Stock Exchange (TSX) and the TSX Venture Exchange (TSX-V) will continue as companies look to access capital, expand operations, finance

acquisitions and secure growth opportunities. Published data indicates that a significant percentage of global equity financings in the mining sector were completed in Canada in 2011, while the resource sectors combined were a significant portion of the Canadian IPO and equity markets. We expect activity in these sectors to continue to lead the market in 2012.

### **NEW GENERATION OF INCOME TRUSTS OFFERS MONETIZATION OPPORTUNITY**

The Canadian income trust market peaked in 2006 with an aggregate market capitalization of C\$225-billion and provided a vehicle for predominantly Canadian-domiciled businesses to distribute cash to public unitholders effectively on a pre-tax basis. On October 31, 2006, the federal government unexpectedly announced a change in tax policy such that the earnings of trusts derived from Canadian businesses would be subject to a tax comparable to that paid by corporations. However, this change did not impact trusts that derive their income from non-Canadian businesses. In December 2010, Eagle Energy Trust completed its IPO in Canada, resulting in the first of a new generation of cross-border trusts, and 2011 subsequently saw a second IPO completed and two additional IPOs proposed. These offerings have reintroduced the income trust model to Canadian capital markets, and owners of U.S.-domiciled energy or other businesses may find the new generation of income trusts provide an attractive monetization opportunity for stable, long-lived income generating energy and other assets.

### **EXPECT ROBUST CANADIAN DOLLAR HIGH-YIELD DEBT ISSUANCE TO CONTINUE**

Since mid-2009 through the end of 2011, more than 30 Canadian companies have issued high-yield bonds denominated in Canadian dollars to Canadian investors in 40 transactions, raising approximately C\$8.7-billion in proceeds, more than half of which was raised in 2011 alone. Although the new issuance market has faced a challenging macro environment since the second half of 2011, we believe that in 2012, the Canadian dollar high-yield debt market will continue to present an attractive option to both first-time and repeat issuers in Canada in light of our highly engaged investor base and active secondary market.

### **RETAIL STRUCTURED PRODUCT SECTOR TO SEE ROBUST PERFORMANCE IN 2012**

In the last 10 years, the retail structured product (RSP) sector has become a significant component of Canadian capital markets, with the sector seeing an aggregate of C\$7.3-billion in new issuances in 2011. We have identified four main trends that we expect to drive performance in the RSP sector in 2012: (1) issuers offering high-yield products in a predominantly low-yield environment; (2) issuers providing alternative asset classes to retail investors

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such as exposure to international assets or global managers/strategies; (3) issuers offering increased access to assets typically difficult for retail investors to properly value or trade, such as convertible debentures or physical commodities; and (4) issuers providing “full-service deals” to retail investors by overlaying strategies that brokers typically cannot provide efficiently, such as covered call deals. Additionally, we expect to see over C\$1-billion in “flow-through” issuances in 2012.

### CANADIAN BANKING AND FINANCIAL INSTITUTIONS WILL CONTINUE TO BE ACTIVE

Canada’s banking and financial institutions have remained relatively strong throughout the global financial crisis and into 2012, which, combined with consistent profitability, strong capitalization and a strong Canadian dollar, has seen these institutions’ profiles rise internationally. We expect that these institutions will continue to be active in both domestic and foreign capital markets and may do so in order to support their efforts to expand internationally, particularly the U.S., while meeting their Basel III obligations. However, newly proposed banking legislation introduced in November 2011 could create new regulatory hurdles for international expansion as the legislation contemplates providing the Minister of Finance with a veto power where a Canadian financial institution intends to make a foreign acquisition that increases its equity by 10 per cent or more.

### NO FEDERAL SECURITIES REGULATOR IN CANADA

The Canadian public capital markets are regulated on a provincial and territorial basis, with each jurisdiction having its own securities legislation. While a substantial degree of co-ordination and co-operation exists among the provinces and territories, and a significant portion of securities laws has been harmonized across Canada, each jurisdiction retains authority over securities regulation within its borders. In 2010, the Canadian federal government published a proposed “national *Securities Act*” to be administered by a single securities regulator, the Canadian Securities Regulatory Authority, which was met with strong opposition in both Quebec and Alberta. In December 2011, the Supreme Court of Canada (SCC) found that the proposed Act was unconstitutional. The SCC decision constitutes a serious, if not fatal, blow to the prospect of comprehensive federal securities regulation in Canada, and it appears that Canadian securities regulation, including the capital markets transactions, will continue to be the domain of provincial and territorial regulators for the foreseeable future.

### REFORMING THE MARKETS FOR OVER-THE-COUNTER DERIVATIVES AND SECURITIZED PRODUCTS

In the aftermath of the global financial crisis, provincial securities regulators took aim at derivatives and structured financial transactions. In order to repair confidence in these markets, increase transparency, reduce systemic risk and address Canada’s G20 commitments on over-the-counter (OTC) derivatives trading, reporting and clearing, the Canadian Securities Administrators (CSA) have produced lengthy consultation papers describing the

underlying issues and proposing regulatory frameworks governing a number of areas. These initiatives, along with those developing along similar lines in other countries, including the evolving rule-making process under the U.S.’s *Dodd-Frank Act*, will be transformational. Previously unregulated and opaque financial transactions will be treated like market securities with substantial oversight and transparency requirements. Specific initiatives include the CSA’s release of a consultation paper for OTC derivatives anticipating the implementation of a “robust” framework covering mandatory OTC derivatives trading, reporting and clearing, as well as surveillance and monitoring, and margin capital market conduct and enforcement rules. With respect to securitized products, the direction of the regulatory proposals is to update, and where appropriate, to harmonize Canada’s disclosure and offering regime to reflect the emerging standards and requirements applicable to securitized products in the U.S., to impose a comprehensive disclosure regime on the private securitization market and to prevent another “made in Canada” market failure akin to the C\$32-billion non-bank asset-backed commercial paper crisis. In the OTC derivatives context alone, six additional consultation papers on the rule-making process are slated for release by the spring of 2012 to be followed by voluminous proposed draft rules. This heavy load of regulation will no doubt capture attention and spawn substantial debate, and will be a significant drain on resources, including for market participants already subject to the consequences of Dodd-Frank. Significant burdens may also be imposed on “large market participants” that are not financial institutions but may nonetheless face a new set of registration requirements in connection with derivatives trading and end-users who expect to be exempt from regulation but may ultimately need to participate in complex indirect derivatives clearing arrangements.

### CLARITY ON BASEL III RULES EMERGES

In December 2010, the picture became a little clearer for banking institutions globally when the Basel Committee on Banking Supervision released the final text of its Basel III Rules, as well as rules regarding minimum requirements to ensure loss absorbency at the point of non-viability and to increase the quality of regulatory capital. In addition, Canada’s banking regulator, the Office of the Superintendent of Financial Institutions (OSFI) released its action plan and further guidance regarding the implementation and interpretation of the Basel III Rules and became the first banking regulator to issue detailed guidance on the implementation of non-viability contingent capital (NVCC) requirements of the Basel III Rules. OSFI’s guidance on the NVCC rules requires that all non-common capital instruments (such as preferred shares and subordinated debt) issued by applicable banking institutions contain provisions requiring such instruments to convert into common equity tier-one capital upon certain trigger events where the banking institution becomes non-viable. The Basel III Rules do not require all non-capital instruments issued to include NVCC features until after January 1, 2013, but we can expect developments on this front in 2012 as banks move toward issuing what will be relatively novel securities.