

# Canadian Preferred Shares Report

July 21, 2021

Fixed Income Group

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## The evaporating Preferred market

For the first half of 2021, there were only a handful of new issues in the Canadian preferred market and redemptions galore; it was like a kettle filled to the top that keeps boiling over. The S&P/TSX Preferred Share Index continued its upward trend for the 2<sup>nd</sup> quarter of 2021, through a robust appetite from individual yield seekers, managed products and the continued redemption of outstanding issues. This forced investors to buy less attractive issues and invest more money into ETFs and mutual fund preferred issues. Several factors contributed to this including but not limited to:

**Negative supply** – There has been approx. \$5 billion in net redemptions (book value) in 2021. Most issuers redeemed preferred shares (prefs) when it was advantageous to do so. Issuers have not been issuing new paper in exchange, but have been using different venues for financing. The first and second quarters saw very few new issues; so there was a dwindling supply of prefs for a second quarter in a row.

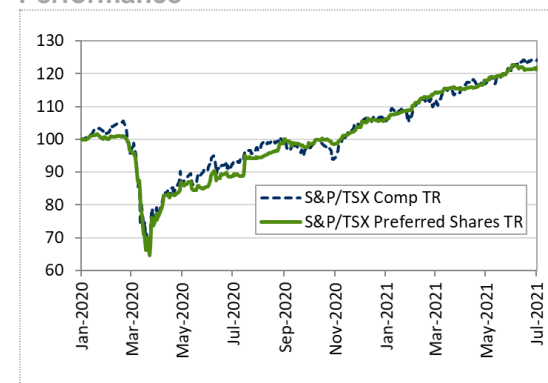
**ETF and Fund inflows** – With issues being called away and no alternative new issues in sight, investors have been pouring money into preferred share ETFs and mutual funds. Approximately \$743 million of new money has gone into these two instruments since the beginning of the year.

**Investors searching for yield** – With fixed income markets trading range bound for many months, investors have been looking for alternatives to increase their overall yields; this has led to increased prices for most classes of preferred shares.

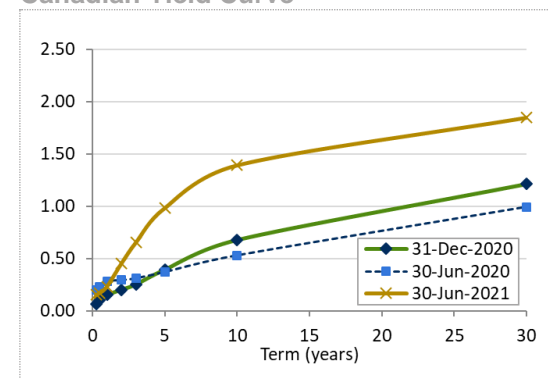
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### Performance



### Canadian Yield Curve



Source: FactSet, Raymond James Ltd.

Please read domestic and foreign disclosure/risk information beginning on page 10.

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## Market Performance

The S&P/TSX Preferred Share Index ended June up 5.02% in total return from the previous quarter; and for the first half of the year, the Index returned a healthy 14.30%, compared to the 16.88% total return of the S&P/TSX Composite Index. The fixed income market fueled the preferred share market's performance for the first half of the year. As fixed income markets continue to shrug off inflation talks and stay range bound in yield, issuers have been calling prefs, thus making any existing issues look more attractive on a relative basis. For the next quarter, we think pref share prices should remain constant. The reasons are lack of new issuance (with banks and lifeco's issuing more and more LRCN bonds), range bound fixed income markets, and issuer redemptions. We caution investors to watch the market for changes in sentiment, credit widening and interest rate volatility in the coming months, namely because of the thinly traded aspect of this type of product. Since prefs have had quite a run over the last 12-15 months in a thinly traded market, gains can evaporate a lot quicker than in a liquid market.

## Redemptions announced in Q3 2021

Issuer	Series	Symbol	Redemption date	Amt (mln)
Scotiabank	36	BNS.PR.G	7/26/2021	\$500
Brookfield Renewable Partners	9	BEP.PR.I	7/31/2021	\$200
Canadian Western Bank	7	CWB.PR.C	7/31/2021	\$140
National Bank	36	NA.PR.A	8/15/2021	\$400
Royal Bank of Canada	BM	RY.PR.R	8/24/2021	\$750
Brookfield Infrastructure Partners	5	BIP.PR.C	9/30/2021	\$250
			<b>Total</b>	<b>\$2,240</b>

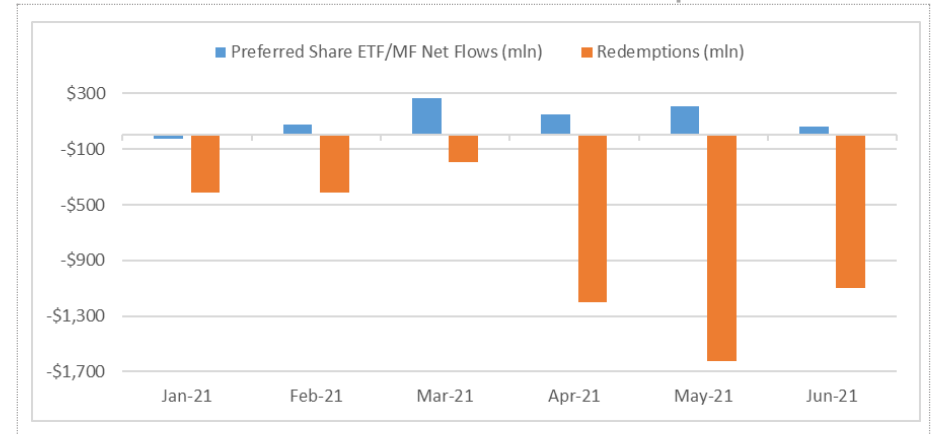
Source: Company Reports, Factset, Raymond James Ltd.

## Fund Flows

Sentiment in the preferred market usually is gauged by flows into the market, through outright buying of pref issues, or by individuals putting money into preferred share ETFs and mutual funds. The first half of 2021 saw net inflows of \$743 million into this managed product, after a weak 2020 saw \$503 mln in net outflows. During the quarter, flows largely came in May, which saw \$209 mln in net buying. Looking closer at these numbers, investors continue to invest in actively managed mandates in keeping with our recommendation of an active mandate over a passive approach. As new issues that attach new features come to the market, combined with lower

levels of liquidity, an actively managed mandate makes more sense for the average investor.

## Preferred Share ETF/ Mutual Fund Flows Vs. Redemptions



Source: Morningstar, FactSet, Raymond James Ltd.

## Market Updates

We expect more banks and lifeco's will continue calling their fixed-reset preferred shares that have high reset spreads, which are costlier to keep outstanding. In particular, the fixed-resets with a reset spread greater than 3%. The expectations of lower supply of bank and lifeco preferred shares going forward, and a relatively flat fixed income market for the next quarter, should produce increased demand for fixed-reset preferred shares, thus providing modest room for capital appreciation and dividend growth.

With the banks and lifecos, which together comprise ~60% of the pref market, favouring LRCN issuance as a cheaper form of financing, there has been a lack of new issuance in the Canadian preferred share market. Two new issues came to market in this last quarter. Emera Inc. tapped the market for a 200 MM Perpetual preferred, with a floor rate attached (details below). It should be noted that the current market is well above issue price. Partners Value Split Corp issued 150 MM of cumulative Retractable Preferred shares.

In addition to the prefs already called in 2021, a further \$2.24 billion has been announced for redemption in the next quarter. We believe this trend will continue in the future.

## New Issues in Q2 2021

Company Name	Series	Ticker	Type	Issue Date
Emera Inc 5 Yr Reset	J	EMA.PR.J	Fixed-Reset	06-Apr-2021
Partners Value Split	12	PVS.PR.J	Synthetic	05-Apr-2021

Source: Company Reports, Factset, Raymond James Ltd.

With respect to credit rating changes, it was a relatively quiet quarter, with just two credit changes.

## Credit Rating Changes

Company Name	Date	Curr Rtg	Last Rtg
Dividend Growth Split Corp	24-Jun-2021	Pfd-3	Pfd-4H
Prime Dividend Corp	22-Jun-2021	Pfd-3 H	Pfd-3

Source: DBRS, WR = Withdrawn Rating, NR = No rating has been requested. July 19, 2021.

## Portfolio Positioning and Where to Look for Opportunities

The Canadian preferred share market usually has a positive correlation to the fixed income markets, meaning if long-term Canadian bonds go up in price and down in

yield, perpetual fixed coupon issues should follow suit and increase in price, but to a maximum amount depending on the call features attached to these issues.

Fixed-reset preferred shares, which make up a majority of the preferred share market, have their dividend rate reset every five years at a spread over the 5-year Government of Canada bond. If the 5-year Canadian bond goes higher in price and lower in yield, the time until next reset date would be a bigger contributor to its return. Usually, a longer period before the next reset would be more favourable in a lower yield environment, giving the investor a higher yield for longer.

On the other hand, if the 5-year Government of Canada bonds are continuing to rise in yield, you should be investing in fixed-reset prefs that are resetting their coupon soon and taking advantage of the higher coupon moving forward. If the reset occurred before the yield increase, they will be stuck with a low coupon for the next 5 years that will probably make their prices lag the market. In either case, you should always try to buy a fixed-reset with a high reset spread rate over Canadian bonds. With that said, there are other factors dictating this market as well, including:

1. Market sentiment and interest rate expectations.
2. Supply and demand
3. Credit quality.
4. Call risk.

## Highlighted: Preferred Shares

## PREFERRED SHARES ANALYSIS - Buy for the Call

General Information			Rating	Price			Possible Calls			Dividend	
Issuer	Series	Symbol	DBRS	Par	19-Jul-2021	Current Cpn	Date	Price	YTC	Annual	MMMM-DD
<b>Fixed Reset</b>											
BANK OF MONTREAL	38	BMO.PR.B	Pfd-2	\$25.00	\$25.55	4.85%	25-Feb-2022	\$25.00	1.98%	\$1.21	FMAN-25
BANK OF MONTREAL	40	BMO.PR.C	Pfd-2	\$25.00	\$25.63	4.50%	25-May-2022	\$25.00	2.22%	\$1.13	FMAN-25
CANADIAN IMPERIAL BANK	45	CM.PR.R	Pfd-2	\$25.00	\$25.32	4.40%	31-Jul-2022	\$25.00	3.04%	\$1.10	JAJO-31
TORONTO-DOMINION BANK	14	TD.PF.H	Pfd-2H	\$25.00	\$25.18	4.85%	31-Oct-2021	\$25.00	1.04%	\$1.21	JAJO-31
<b>TOTAL</b>											
General Information											
Issuer	Series	Symbol	Notes- Reset Spreads								
<b>Fixed Reset</b>											
BANK OF MONTREAL	38	BMO.PR.B	5yr GoC +4.06%								
BANK OF MONTREAL	40	BMO.PR.C	5yr GoC +3.33%								
CANADIAN IMPERIAL BANK	45	CM.PR.R	5yr GoC +3.38%								
TORONTO-DOMINION BANK	14	TD.PF.H	5yr GoC +4.12%								
<b>TOTAL</b>											

Source: FactSet, Raymond James Ltd., prices as of July 19th

### **Rationale**

With all of the issues being called in the preferred market right now, a different way of looking at these issues is to buy them in the hope they are called. And if they aren't, you will still be receiving a generous spread over Canada bonds.

### **Key Factors**

1. Good Yield to the Call date vs. any other Money Market instrument.
2. High chance of issues being called because of the reset spreads.
3. If issues not called, a healthy reset rate versus Canada bonds

With all of these factors in mind, we have provided a list of issues that we feel are attractive in this market.

## PREFERRED SHARES ANALYSIS- Highlighted Issues

Issuer	General Information		Rating	Price			Dividend		Possible Calls			
	Series	Symbol	DBRS	Par	19-Jul-2021	Current Yield	Annual	MMMM-DD	Date	Price	YTC	
<b>Fixed Reset</b>												
CANADIAN IMPERIAL BANK	51	CM.PR.Y	Pfd-2	\$25.00	\$26.20	4.91%	\$1.29	JAJO-31	31-Jul-2024	\$25.00	3.32	
ENBRIDGE INC	17	ENB.PF.I	Pfd-3H	\$25.00	\$25.29	5.09%	\$1.29	MJSD-1	01-Mar-2022	\$25.00	3.79	
FAIRFAX FINL HLDGS LTD	M	FFH.PR.M	Pfd-3H	\$25.00	\$25.09	4.99%	\$1.25	MJSD-31	31-Mar-2025	\$25.00	4.97	
ROYAL BANK OF CANADA	BD	RY.PR.J	Pfd-2H	\$25.00	\$24.36	3.28%	\$0.80	FMAN-24	24-May-2025	\$25.00	3.87	
TORONTO-DOMINION BANK	24	TD.PF.M	Pfd-2H	\$25.00	\$26.23	4.86%	\$1.28	JAJO-31	31-Jul-2024	\$25.00	3.19	
<b>Perpetuals</b>												
POWER FINANCIAL CORP	V	PWF.PR.Z	Pfd-2H	\$25.00	\$25.97	4.96%	\$1.29	JAJO-31	31-Jul-2022	\$26.00	4.13	
<b>Floating</b>												
FAIRFAX FINL HLDGS LTD	D	FFH.PR.D	Pfd-3H	\$25.00	\$21.13	3.80%	\$0.80	MJSD-31	31-Dec-2024	\$25.00	8.43	
FAIRFAX FINL HLDGS LTD	J	FFH.PR.J	Pfd-3H	\$25.00	\$18.95	3.85%	\$0.73	MJSD-31	31-Dec-2025	\$25.00	9.87	
SUN LIFE FINANCIAL INC	11QR	SLF.PR.K	NR	\$25.00	\$23.40	2.39%	\$0.56	MJSD-31	30-Sep-2021	\$25.00	N/A	
<b>Synthetic</b>												
DIVIDEND 15 SPLIT CORP		DFN.PR.A	Pfd-3	\$10.00	\$10.15	5.17%	\$0.53	monthly-10	19-Aug-2021	\$10.00	-11.89	
DIVIDEND 15 SPLIT CORP II		DF.PR.A	Pfd-4	\$10.00	\$10.16	5.17%	\$0.53	monthly-10	01-Dec-2024	N/A	N/A	
<b>Retractable</b>												
CANOE EIT INCOME FUND	1	EIT.PR.A	Pfd-2H	\$25.00	\$25.95	4.66%	\$1.20	MJSD-15	15-Mar-2022	\$25.75	5.36	
<b>US Dollar</b>												
ENBRIDGE INC	J	ENB.PR.U	Pfd-3H	\$25.00	\$20.60	5.93%	\$1.22	MJSD-1	01-Jun-2022	\$25.00	27.92	
ENBRIDGE INC	1	ENB.PR.V	Pfd-3H	\$25.00	\$22.35	6.65%	\$1.49	MJSD-1	01-Jun-2023	\$25.00	12.95	
<b>TOTAL</b>												

Issuer	Series	Symbol	General Information	
			Notes	
<b>Fixed Reset</b>				
CANADIAN IMPERIAL BANK	51	CM.PR.Y	5yr GoC +3.62%	
ENBRIDGE INC	17	ENB.PF.I	5yr GoC +4.14% (Min 5.15%)	
FAIRFAX FINL HLDGS LTD	M	FFH.PR.M	5yr GoC +3.98%	
ROYAL BANK OF CANADA	BD	RY.PR.J	5yr GoC +2.74%	
TORONTO-DOMINION BANK	24	TD.PF.M	5yr GoC +3.56%	
<b>Perpetuals</b>				
POWER FINANCIAL CORP	V	PWF.PR.Z	Coupon Fixed at 5.15%	
<b>Floating</b>				
FAIRFAX FINL HLDGS LTD	D	FFH.PR.D	3-Mo T-Bill + 3.15	
FAIRFAX FINL HLDGS LTD	J	FFH.PR.J	3-Mo T-Bill + 2.85	
<b>Synthetic</b>				
DIVIDEND 15 SPLIT CORP	0	DFN.PR.A	Current Coupon 5.50%	
DIVIDEND 15 SPLIT CORP II	0	DF.PR.A	Current Coupon 5.75%	
<b>Retractable</b>				
CANOE EIT INCOME FUND	1	EIT.PR.A	Current Coupon 4.80%	
<b>US Dollar</b>				
ENBRIDGE INC	J	ENB.PR.U	US 5-yr + 3.05%	
ENBRIDGE INC	1	ENB.PR.V	US 5-yr + 3.14%	
<b>TOTAL</b>				

Source: FactSet, Raymond James Ltd., prices as of July 19, 2021

## Most Actively Traded

Trading volume data as at July 19, 2021. 30-Day = Average volume over past 30 days.  
5-Day = Average volume over past 5 days

### Floating-Rate

Issuer	Series	Symbol	30-Day	5-Day
BROOKFIELD ASSET MAN INC	2	BAM.PR.B	23,627	75,296
BROOKFIELD ASSET MGMT	13	BAM.PR.K	22,267	65,916
BCE INC	AE	BCE.PR.E	17,694	43,854
BCE INC	AD	BCE.PR.D	16,659	12,280
BCE INC	AB	BCE.PR.B	12,415	16,642
BCE INC	Y	BCE.PR.Y	12,213	11,832
BCE INC	AJ	BCE.PR.J	8,878	16,648
BROOKFIELD ASSET MAN INC	4	BAM.PR.C	7,581	9,754
BCE INC	S	BCE.PR.S	6,330	6,489
BCE INC	AH	BCE.PR.H	6,193	26,248

### Retractable

Issuer	Series	Symbol	30-Day	5-Day
CANOE EIT INCOME FUND	2	EIT.PR.B	1,980	722
CANOE EIT INCOME FUND	1	EIT.PR.A	1,609	2,004
BIRCHCLIFF ENERGY LTD	C	BIR.PR.C	1,221	625
BROOKFIELD INVESTMENTS	A	BRN.PR.A	724	687
CANADIAN GENL INVESTMENT	4	CGI.PR.D	590	760

### Perpetual

Issuer	Series	Symbol	30-Day	5-Day
SUN LIFE FINANCIAL INC	1	SLF.PR.A	14,851	11,131
GREAT-WEST LIFECO INC	H	GWO.PR.H	13,677	6,334
SUN LIFE FINANCIAL INC	2	SLF.PR.B	13,481	25,573
BROOKFIELD ASSET MAN INC	36	BAM.PF.C	11,477	2,824
BROOKFIELD ASSET MAN INC	37	BAM.PF.D	11,197	3,183
MANULIFE FINANCIAL CORP	3	MFC.PR.C	10,224	8,564
SUN LIFE FINANCIAL INC	4	SLF.PR.D	8,930	26,976
BOMBARDIER INC	4	BBD.PR.C	8,804	10,639
SUN LIFE FINANCIAL INC	3	SLF.PR.C	8,510	27,122
CANADIAN UTILITIES LTD	EE	CU.PR.H	6,799	31,699

### Fixed-Reset

Issuer	Series	Symbol	30-Day	5-Day
BANK OF NOVA SCOTIA	36	BNS.PR.G	47,487	22,735
FORTIS INC	M	FTS.PR.M	43,762	15,241
POWER FINANCIAL CORP	P	PWF.PR.P	40,415	98,388
BCE INC	AK	BCE.PR.K	35,281	35,931
CANADIAN IMPERIAL BANK	45	CM.PR.R	35,091	19,510
NATIONAL BANK OF CANADA	36	NA.PR.A	28,679	72,776
TC ENERGY CORP	15	TRP.PR.K	27,177	20,880
BANK OF MONTREAL	40	BMO.PR.C	26,440	8,135
SUN LIFE FINANCIAL INC	12R	SLF.PR.I	24,781	24,495
ENBRIDGE INC	19	ENB.PF.K	24,105	70,707

## Appendix A: Yield Tables

Yields tables are included as a separate report/attachment, and are also available from the Fixed Income Group of Raymond James Ltd.

## Appendix B: Credit Ratings Comparisons

DBRS	S&P	S&P Global	Description
Pfd-1 (high)	P-1 (high)	AA	<b>Superior:</b> High quality with minimal credit risk. Such a rating is backed by strong earnings and balance sheet.
Pfd-1	P-1	AA-	
Pfd-1	P-1	A+	
Pfd-1 (low)	P-1 (low)	A	
Pfd-1 (low)	P-1 (low)	A-	
Pfd-2 (high)	P-2 (high)	BBB+	<b>Satisfactory:</b> Upper-medium grade and comes with moderate credit risk. There is substantial protection of dividend and principal.
Pfd-2	P-2	BBB	
Pfd-2 (low)	P-2 (low)	BBB-	
<b>Investment Grade Cut-Off</b>			
Pfd-3 (high)	P-3 (high)	BB+	<b>Adequate:</b> Medium grade and comes with moderate credit risk. There may be speculative characteristics.
Pfd-3	P-3	BB	
Pfd-3 (low)	P-3 (low)	BB-	
Pfd-4 (high)	P-4 (high)	B+	<b>Speculative:</b> substantial credit risk, and are speculative in nature. The protection of dividend and principal is uncertain, but especially so during times of economic adversity.
Pfd-4	P-4	B	
Pfd-4 (low)	P-4 (low)	B-	
Pfd-5 (high)	P-5 (high)	CCC+	<b>Highly Speculative:</b> Very high credit risk due to chance of default. The protection of dividend and principal is uncertain.
Pfd-5	P-5	CCC	
Pfd-5 (low)	P-5 (low)	CCC-	
Pfd-5 (low)	CC	CC	
Pfd-5 (low)	C	C+	
Pfd-5 (low)	C	C	
Pfd-5 (low)	C	C-	
D	D	D	
			<b>In Arrears:</b> The lowest rated class. Low prospect for recovery of principal and interest.

## Appendix C: Education and Glossary

### What are Preferred Shares?

Preferred shares are equity securities that provide investors a fixed dividend that must be paid out before common share dividends are paid. Preferred shares have characteristics of both equity and debt instruments. The fixed dividend is stated by a coupon rate and is commonly paid out quarterly. In the event of a dissolution or liquidation of the issuer, preferred shareholders' claims on assets are senior to common shareholders but behind debt holders.

### Preferred Shares vs Common Shares

- Like most common shares, these are equity instruments that pay dividends
- Potential for price appreciation but price is less volatile than common shares
- Not able to participate in the upside profits from ownership of the company and usually have no voting rights unlike common shares

### Preferred Shares vs Debt Securities

- React similarly to interest rates as bond instruments
- Many preferred shares are issued at a fixed par value
- Rated by the major credit rating agencies
- Redeemable for a set amount at the end of a fixed term
- Typically pay a fixed dividend

### What are the Benefits?

- **Favourable tax treatment:** Better after-tax return for preferred share distributions from Canadian corporations; preferred dividends are less heavily taxed due to the dividend tax credit compared to interest which is fully taxable as income under Canadian federal and provincial legislation.
- **Higher yield than other fixed income products:** Preferreds tend to have higher yields than other fixed income products such as bonds since distributions are less assured. Yields are not guaranteed but many major public companies will meet preferred share obligations even in times of losses. However, some issuers have the right to defer (or suspend) payment of dividends upon financial hardship.
- **Price stability compared to common shares:** Less volatility in price of preferreds.

- **Addresses reinvestment risk:** available in longer terms unlike money market products such as GICs

### What are the Drawbacks?

- **Interest Rate Risk:** Many preferreds pay a fixed rate distribution similar to fixed income securities; there is an inverse relationship between changes in interest rates and the price of the preferred shares. Price sensitivity of the preferreds is greater for longer terms and for lower coupon rates. Preferreds are less price sensitive to interest rate fluctuations than bonds.
- **Call Risk:** Callable preferreds tend to have higher yield to maturities given the call risk. However, the call risk is a disadvantage to the investor for the following reasons: future dividend income stream is uncertain, and there is reinvestment risk for the investor since the issuer often exercises the call provision when interest rates have fallen in order to refinance at lower rates. Callable issues are unlikely to appreciate in price when interest rates fall and possibly decline below the call price given a significant rise in rates.
- **Credit Risk:** Independent agencies such as the Dominion Bond Rating Service (DBRS), and Standard & Poor's (S&P), assess an issuer's ability to fulfill its obligations and assign a credit rating. A decline in credit quality can negatively affect the price of preferreds and the dividend policy of the issuer.
- **Liquidity Risk:** Preferreds often have light trading volumes, i.e., "thin" markets. This lack of liquidity can cause exaggerated swings in price when buy or sell volumes pick up from normal levels.

### What to Look for in Buying Preferreds?

- **Credit Quality:** Higher quality preferreds provide higher assurance of a dependable income stream. The price of preferred shares is likely to erode much more upon the issuer facing financial difficulty than from a shift in rates. High credit quality preferreds are rated P1 and P2 by DBRS.
- **Yield to Call/Redemption:** This is the yield shown to a call date or reset date.
- **Liquidity:** - Certain issuers are more easily purchased or sold on the market due to higher liquidity. The size of the initial preferred offering can influence liquidity. In general, the larger the issuance size, the better the liquidity.
- **Diversification:** Selecting preferreds in different industries and with different features can help provide balance and flexibility to an investor.



## Types of Preferred Shares

Preferreds can be structured in a variety of ways based on a combination of features related to the 1) term or maturity (fixed or no maturity date), 2) payment provision (fixed or floating rate), 3) dividend policy (cumulative or non-cumulative), and 4) other unique qualities. It is easy to see that there can be a number of different combinations of the different features for preferred shares which give the holder/issuer different rights. Therefore, prior to investing in preferred shares, it is important to understand the specific features of the particular preferred share issuance. The following is a description of the different types of preferred shares.

### 1. Term to Maturity

- Perpetual/straight preferreds have no fixed maturity date; the stated dividend rate is paid in perpetuity. The issuer does have redemption rights.
- (Hard) Retractable/term preferreds have a set maturity date at the time of issue; the investor would get back the capital investment at the end of the specified period.
- Soft Retractable preferreds pay out the retraction amount either as cash or an equivalent amount in common shares of the issuer, at the option of the issuer. Typically, the stock price used to calculate the number of common shares is 95% of the average price of the common shares in a period before the retraction occurs.

### 2. Payment Provision

- Fixed Rate preferreds have a fixed dividend at issue date, which can be a fixed dollar value of a stated percentage of par value, normally paid quarterly
- Floating Rate preferreds offer a floating dividend tied to a benchmark, typically as a percentage of the bank prime rate
- Fixed Resets pay a fixed dividend rate for a specified period, usually for five years after their date of issue. On or after that date and on every fifth anniversary, if the issue is not redeemed by the issuer, the holder has the option to either receive a floating-rate dividend, or exchange the series for a further series of a fixed-rate preferred.

### 3. Dividend Policy

- Cumulative means any missed dividends are accumulated and paid in full before common dividends are paid or preferred shares are redeemed.
- Non-cumulative means dividends are paid only when declared and do not accumulate if missed. The trend in the marketplace has been issuances with non-cumulative preferred shares.

### 4. Other Features

- Convertible preferreds allow the holder to convert the preferreds into common shares based on a specified conversion formula; there are not many of these in the market nowadays.
- Redeemable or Callable features allow the issuer to reserve the right to redeem or “buy back” shares at a predetermined price after a specific date. A small premium above the par value per share is often paid as compensation to the investor when the shares are called. Non-callables, which are rare, cannot be called or redeemed as long as the issuing company is in existence.

Some other types of preferred shares have characteristics that are quite different from conventional preferred shares:

- Deferred Preferred Shares are non-dividend-paying preferred shares; similar to strip bonds, the shares are redeemed at a set par value on a set date in the future. However, unlike strip bonds, the accrued dividends (the dividend premium) on a deferred preferred share are not subject to yearly tax. When the holder is an individual, such dividends do not qualify for the gross-up and dividend tax credit rules normally applicable to dividends received by individuals from taxable Canadian corporations. If the preferred is held to redemption, the accrued dividends are fully taxable as interest income.
- Synthetic Preferreds (Split Shares, Structured, and Equity Dividend Shares) are preferreds where holders give up the right to all capital gains to common shareholders while receiving all the dividends on the common shares. The maturity values of such structured shares are dependent upon the value of the underlying common. Another feature of many split shares is a possible early redemption date.

## Tax Consequences

For tax purposes, there is usually a disposition when preferred shares are redeemed or called. Here is a list of tax related terminology associated with such an event.

- **Deemed Dividend:** The difference between the redemption price and the shares' paid up capital
- **Deemed Proceeds of Disposition:** The deemed dividend deducted from the redemption price
- **Adjusted Cost Base (ACB):** This is generally the purchase price plus sales commissions
- **Capital Gain/Loss on the Disposition:** The amount the deemed proceeds of disposition exceeds (or is less than) the adjusted cost base

The following table provides a few illustrative examples of the tax consequences upon redemption of preferred shares.

### Tax Consequences

Redemption	Tax Consequence
Redemption Price Equals Paid-up Capital	<ul style="list-style-type: none"> <li>▪ No deemed dividend</li> <li>▪ Deemed proceeds of disposition is the paid-up capital</li> </ul>
Redemption When Paid-Up Capital Is Less Than Par	<ul style="list-style-type: none"> <li>▪ Can result in a significant deemed dividend</li> <li>▪ Deemed proceeds of disposition well below par resulting in the realization of a significant capital loss on the redemption</li> </ul>
Purchase price above par value & Redemption at Par	<ul style="list-style-type: none"> <li>▪ Capital loss, can offset any capital gains realized in calendar year of redemption or carry back 3 years or carry forward indefinitely</li> </ul>
Redemption Price Above Par	<ul style="list-style-type: none"> <li>▪ Paid-up capital rarely greater than par; thus, this results in deemed dividend</li> <li>▪ Deemed proceeds of disposition is the paid-up capital</li> </ul>

***Please note that the tax implications in the examples are for illustrative purposes only, and should not be considered an interpretation of the Income Tax Act, nor do they purport to constitute specific tax advice. Clients should seek independent advice on tax-related matters from qualified professionals licensed to practice in that area.***

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