

Ontario Securities Commission

Companion Policy 91-501CP

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**COMPANION POLICY 91-501CP
STRIP BONDS**

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PART 1 INTRODUCTION

Introduction

1.1 The purpose of this Policy is to state the Commission's interpretation of certain provisions of Rule 91-501 Strip Bonds (the "Rule"), and to bring certain matters relating to the Rule to the attention of participants in the strip bond market.

PART 2 DEFINITION OF STRIP BONDS

Interests in Pools

2.1 The definition of strip bonds includes interests in pools of amounts described in paragraph (a) of the definition. An interest in a pool, in this context, would include an interest in strip bonds held through deposit receipts that represent a non-traceable interest in underlying physical coupons or bonds. The effect of including pools of this nature in the Rule is to permit a depository to hold physical coupons or bonds en bloc, and to issue deposit receipts in various principal amounts that do not necessarily correspond to specific coupons or bonds. Interests in pools can appropriately be treated as strip bonds as long as it is clear that holding an interest in a pool represents a right to receive a sum certain in money at a specific future date rather than amounts determined on the basis of the performance of a portfolio of securities.

Strip Bond Packages

2.2 The definition of strip bond includes strip bond packages, which are defined to mean a security, other than an underlying bond, consisting of two or more of the interests described in paragraph (a) of the definition of strip bonds. This inclusion has been made to ensure that strip bond information statements contain disclosure about strip bond packages as well as ordinary strip bonds. The Investment Dealers Association of Canada information statement accepted by the Director for use under the predecessor policy to the Rule treats strip bond packages separately from strip bonds in several respects. For instance, the statement discloses that the payment characteristics of strip bond packages may more closely resemble conventional debt than strip bonds. In contrast to strip bonds, the income stream received on a strip bond package prior to maturity or the final payment date may be reinvested at the then prevailing interest rates. Therefore, the market price of a strip bond package will not be as volatile as the market price of a strip bond with the same credit risk and term to maturity or final payment date. However, it may be more volatile than the market price of a conventional interest-bearing debt security with the same credit risk and term to maturity. Also, strip bond packages are treated differently for tax purposes than strip bonds.

PART 3 REGISTRATION EXEMPTIONS

Removal of Registration Exemptions

3.1 Section 2.1 of the Rule provides that the exemption from the dealer registration requirement and the exemption from the prospectus requirement referred to in that section are not available for a trade in a specified strip bond (as defined in section 1.1 of the Rule). Specified strip bonds are those strip bonds for which a registration or prospectus exemption is not provided in the Act (e.g., foreign government strip bonds).

Provision of Registration Exemptions

3.2 (1) The Rule provides registration exemptions for trades of specified strip bonds in three situations.

(2) First, a registration exemption is provided by paragraph 2.2(a) of the Rule for trades of specified strip bonds by non-market intermediaries; this exemption ensures that persons who are not market intermediaries may trade in specified strip bonds without compliance with the Rule on the same basis as they could trade in other exempt securities under the Act.

(3) Second, a registration exemption is provided by paragraph 2.2(b) of the Rule for trades of specified strip bonds by a "qualified market intermediary" to a person or company that is not a specified purchaser. A qualified market intermediary is defined in the Rule to be a market intermediary that, in effect, is permitted to trade in government bonds; the effect of this exemption, therefore, is to make available a registration exemption for specified strip bonds to those persons or companies who are permitted to trade in the underlying government bonds.

(4) The Commission notes that the term "qualified market intermediaries" includes both those market intermediaries that are permitted to trade in government securities pursuant to their registration, or pursuant to an exemption from registration that has not been made unavailable to the intermediary.

(5) Third, a registration exemption is provided by paragraph 2.2(c) of the Rule for trades of specified strip bonds by a qualified market intermediary to a person or company that is a specified purchaser if that purchaser receives the specified strip bond information statement before the specified purchaser enters into an agreement of purchase and sale relating to the trade.

PART 4 DELIVERY OBLIGATION

Delivery Obligation

4.1 Paragraph 2.2(c) and section 3.1 of the Rule impose an obligation for the delivery of a strip bond information statement before an agreement of purchase and sale relating to a trade in a strip bond is entered into. The Commission notes that this obligation may be satisfied in a number of ways, so long as delivery of a current strip bond information statement has been made to a specified purchaser by that time. For instance, a registrant could satisfy the obligation by effecting a mass mailing of the statement to all of its clients, or by routinely delivering the statement to each client when the client opens an account with the registrant.

Beneficiaries of Defined Contribution Pension Plans

4.2 Section 1.2 of the Rule includes in the definition of "specified purchaser" a beneficiary of a defined contribution pension plan for whose benefit a strip bond is purchased, and who made the investment decision to purchase the strip bond. The effect of section 1.2 of the Rule is to ensure that defined contribution pension plan members who make investment decisions to purchase strip bonds are treated as purchasers under the Rule, even though those members likely will not directly enter into an agreement of purchase and sale for the strip bonds with the seller of the strip bonds. Under section 1.2, a seller of strip bonds must provide the pension plan member with a strip bond information statement if a copy of that statement has not been previously delivered to him or her (i.e., if that member is a "specified purchaser"), and that delivery must take place before the seller enters into the agreement of purchase and sale in respect of that sale, even if the agreement of purchase and sale is with the pension plan rather than the pension plan member.

PART 5 STRIP BOND INFORMATION STATEMENTS

Strip Bond Information Statements

5.1 (1) A strip bond information statement is defined in the Rule as an information statement that has been accepted by the Director, if that acceptance has not been revoked, and satisfies the information requirements of the definition.

(2) The effect of this definition is that a strip bond information statement is not a strip bond information statement for the purposes of the Rule if it does not include information required to be included, or, in a material respect, contains any information that is misleading or untrue or omits to include any information in the information statement that is necessary to make other information in the information statement not misleading in the light of the circumstances in which it is made, even if the Director has accepted the information statement and has not taken the step of revoking his or her acceptance of the statement. The onus is on the person or company using a strip bond information statement to ensure that it satisfies the information requirements of the definition.

PART 6 FEES

Fees

6.1 A submission of a proposed strip bond statement to the Director for acceptance should be accompanied by the fee referred to in item E1 of Appendix C of OSC Rule 13-502 *Fees*.