

June 4, 2014

**IN THE MATTER OF
THE SECURITIES LEGISLATION OF
ALBERTA, BRITISH COLUMBIA, MANITOBA, NEWFOUNDLAND AND LABRADOR,
NOVA SCOTIA, ONTARIO, AND SASKATCHEWAN (THE JURISDICTIONS)**

AND

**IN THE MATTER OF
THE PROCESS FOR EXEMPTIVE RELIEF APPLICATIONS IN MULTIPLE
JURISDICTIONS**

AND

**IN THE MATTER OF
THE INVESTMENT INDUSTRY REGULATORY ORGANIZATION OF CANADA (THE
FILER)**

AND

A STRIP BOND INFORMATION STATEMENT

DECISION

Background

The securities regulatory authority or regulator in each of the Jurisdictions (the **Decision Maker**) has received an application (the **Application**) from the Filer for a decision under the securities legislation of the Jurisdictions (the **Legislation**) that each Decision Maker approves, accepts or finds satisfactory the form of information statement (the **Revised Strip Bond Information Statement**) submitted with the Application, and attached as Schedule A (the **Information Statement Approval**).

Under the Process for Exemptive Relief Applications in Multiple Jurisdictions (for a coordinated review application):

- (a) the Ontario Securities Commission is the principal regulator for this application; and
- (b) the decision is the decision of the principal regulator and evidences the decision of each other Decision Maker.

Interpretation

Terms defined in National instrument 14-101 Definitions have the same meaning if used in this decision, unless otherwise defined.

Representations

This decision is based on the following facts represented by the Filer:

1. The Filer is the national self-regulatory organization which oversees all investment dealers and trading activity on debt and equity marketplaces in Canada. The Filer's mandate is to set and enforce high-quality regulatory and investment industry standards, protect investors and strengthen market integrity while maintaining efficient and competitive capital markets.
2. The Filer's head office is in Toronto, Ontario.
3. The Filer is not in default of securities legislation in any jurisdiction.
4. The Legislation contains exemptions from dealer registration and prospectus requirements for strip securities (**strip bonds**) that are based on bonds of the Government of Canada, a Canadian province, or certain foreign governments or political subdivisions thereof. These exemptions require that first-time purchasers be provided with an information statement or similar document that is, depending on the Jurisdiction, approved by, accepted by or satisfactory to the Decision Makers (the **Information Statement Delivery Requirements**).
5. The Filer has prepared the Revised Strip Bond Information Statement and is seeking the Information Statement Approval so that the Revised Strip Bond Information Statement may be used by investment dealers who are regulated by the Filer (**Dealer Members**) to satisfy the Information Statement Delivery Requirements.
6. Other market participants may also use the Revised Strip Bond Information Statement to satisfy the Information Statement Delivery Requirements, and the Filer does not object to such use.
7. In the Filer's view, having the Filer prepare the Revised Strip Bond Information Statement and obtain the Information Statement Approval is consistent with the Filer's mandate because it permits the provision by Dealer Members of a standardized and accurate information statement that complies with the Information Statement Delivery Requirements and promotes investor protection.
8. The Information Statement Delivery Requirements are contained in:
 - (a) requirements in the Legislation that must be satisfied in order for a person or company to be able to rely upon an exemption from the dealer registration requirement or the prospectus requirement for trading in strip bonds; or
 - (b) requirements in the Legislation applicable to trading by registrants in strip bonds.
9. As required by the Information Statement Delivery Requirements, the Revised Strip Bond Information Statement describes the investment attributes of strip bonds and clearly describes:

- (a) the nature of strip bonds, the rights of holders of strip bonds and how strip bonds differ from conventional interest-bearing debt securities;
 - (b) the fluctuations, and volatility of fluctuations, in the market price and value of strip bonds resulting from fluctuations in interest rates;
 - (c) the effect on the volatility of fluctuations referred to in paragraph (b) associated with the time to maturity of strip bonds;
 - (d) the secondary market for strip bonds and underlying bonds;
 - (e) custodial arrangements for strip bonds and underlying bonds;
 - (f) the Canadian federal income tax consequences of buying, selling and holding strip bonds; and
 - (g) the existence of dealer mark-ups or commissions on the purchase and sale of strip bonds and the impact, illustrated in tabular form, of different mark-ups or commissions on the yield to maturity of a strip bond, and includes a statement inviting the prospective purchaser or seller of a strip bond to compare the yield to maturity of the strip bond, calculated after giving effect to any applicable dealer mark-up or commission, against the similarly calculated yield to maturity of a conventional interest-bearing debt security, and to inquire about the dealer's bid and ask prices for the subject strip bond.
10. The Revised Strip Bond Information Statement is substantively similar to an earlier information statement dated June 2003 (the **Previous Strip Bond Information Statement**), which was submitted by the Filer's predecessor, the Investment Dealers Association, to the Decision Makers and, depending upon the Jurisdiction, approved or accepted by, or determined to be satisfactory to, the Decision Makers in Alberta, Manitoba, Newfoundland and Labrador, Nova Scotia, Ontario, Quebec and Saskatchewan on or around July 28, 2003.
11. The Decision Maker in British Columbia approved the Previous Strip Bond Information Statement on July 31, 2003.
12. The Revised Strip Bond Information Statement differs from the Previous Strip Bond Information Statement in the following respects:
- (a) the table in the Previous Strip Bond Information Statement illustrating the after-commission yield to a strip bond holder with different terms to maturity has been simplified to assume a before-commission yield of 5.5%;
 - (b) the tax tables and formulas provided in the Previous Strip Bond Information Statement describing the income tax treatment of strip bonds have been removed to avoid any inconsistencies with official tax guidance issued by the Canada Revenue Agency (the **CRA**);
 - (c) the section in the Previous Strip Bond Information Statement discussing the tax treatment of strip bond packages has been modified to reflect guidance received by the Filer indicating that the

CRA may accept alternative tax reporting methods in cases where the strip bond package is issued at or near par and is kept intact; and

(d) the Revised Strip Bond Information Statement incorporates certain other minor drafting changes of a non-substantive nature to simplify and clarify for average retail investors the essential features and the general risks and tax considerations associated with investing in strip bonds and strip bond packages.

13. Following the issuance of this decision, the Filer will announce a date after which it will encourage its Dealer Members to use the Revised Strip Bond Information Statement instead of the Previous Strip Bond Information Statement in order to comply with applicable Information Statement Delivery Requirements.

Decision

Each of the Decision Makers is satisfied that the decision meets the test set out in the Legislation for the Decision Maker to make the decision.

The decision of the Decision Makers under the Legislation is that the Information Statement Approval is granted.

“Jo-Anne Matear”

Jo-Anne Matear
Manager, Corporate Finance

SCHEDULE A

STRIP BONDS AND STRIP BOND PACKAGES INFORMATION STATEMENT

We are required by provincial securities regulations to provide you with this Information Statement before you can trade in strip bonds or strip bond packages based on bonds of the Government of Canada, a Canadian province, or certain foreign governments or political subdivisions thereof. Please review it carefully.

Preliminary Note Regarding the Scope of this Information Statement

This information statement relates to strip securities that are based on bonds of the Government of Canada, a Canadian province, or certain foreign governments or political subdivisions thereof. Provincial securities regulations create an exemption from dealer registration and prospectus requirements for these types of securities.

Strip securities may also be based on Canadian corporate bonds. While some of the information in this Information Statement may also be relevant to corporate bond-based strips, corporate bond-based strips are outside the scope of this Information Statement. If you are planning to purchase a strip or strip package based on a corporate Canadian bond, please note that such securities are not governed by the regulations referred to above, but rather, may be subject to certain decisions issued by Canada's securities regulatory authorities exempting certain Canadian corporate bond-based strip securities from various regulatory requirements, including Section 2.1 of National Instrument 44-102 – *Shelf Distributions* and Section 2.1 of National Instrument 44-101 – *Short Form Prospectus Distributions*. See e.g. *RBC Dominion Securities Inc. et al.*, (2013) 36 OSCB 3867 (Apr. 8), online: www.osc.gov.on.ca/en/SecuritiesLaw_ord_20130411_2110_rbc-dominion.htm. Pursuant to each such decision, Canadian securities dealers file with the applicable Canadian securities regulatory authorities a short form base shelf prospectus and certain supplements thereto, pursuant to which certain Canadian corporate-bond based strip securities may be distributed on an on-going basis without a full prospectus (the “CARs¹ and PARs² Programme”). For each decision, the applicable shelf prospectus and its supplements may be found on the System for Electronic Document Analysis and Retrieval or “SEDAR” at www.sedar.com.

Risk and other disclosures relating to securities issued as part of the CARs and PARs Programme are set forth in the shelf prospectus and supplements published on SEDAR, and investors considering purchasing such securities are advised to consult these documents, since considerations unique to securities issued as part of the CARs and PARs Programme are not addressed herein.

¹ CARs are corporate strip bonds comprised of coupon and residual securities.

² PARs are a form of strip bond package where the coupon rate is reduced to current yields, thus allowing the package to be sold at par.

Strip Bonds and Strip Bond Packages (“Strips”)

A strip bond—commonly referred to as a “strip”—is a fixed-income product that is sold at a discount to face value and matures at par. This means the holder is entitled to receive the full face value at maturity. Strips do not pay interest, but rather, the yield at the time of purchase is compounded semi-annually and paid at maturity. Since the return on a strip is fixed at the time of purchase, strips may be a suitable investment where the holder requires a fixed amount of funds at a specific future date.

A strip is created when a conventional debt instrument, such as a government or corporate bond, discount note or asset-backed security (i.e., the “underlying bond”), is separated into its “interest” and “principal” component parts for resale. Components are fungible and may be pooled together where they share the same issuer, payment date and currency and have no other distinguishing features. The two types of components may be referred to as follows:

- The “coupon”: the interest-paying portion of the bond; and
- The “residual”: the principal portion.

A strip bond package is a security comprised of two or more strip components. Strip bond packages can be created to provide holders with a regular income stream, similar to an annuity, and with or without a lump sum payment at maturity.³ By laddering strips with staggered maturities or other payment characteristics, holders can strategically manage their cash flow to meet their future obligations and specific needs.

Strips vs. Conventional Bonds

Strips are offered on a variety of terms and in respect of a variety of underlying bonds, including government bonds issued by the Government of Canada or provincial, municipal and other government agencies, or a foreign government. CARs and PARs are examples of strips derived from high-quality corporate bonds. Some differences between strips and conventional bonds that you may wish to consider include the following:

- strips are sold at a discount to face value and mature at par, similar to T-bills. Unlike conventional interest-bearing debt securities, strips do not pay interest throughout the term to maturity; rather, the holder is entitled to receive a fixed amount at maturity. The yield or interest earned is the difference between the discounted purchase price and the maturity value; thus, for a given par value, the purchase price for a strip will typically be lower the longer the term to maturity;
- a strip with a longer term to maturity will generally be subject to greater price fluctuations than a strip of the same issuer and yield but with a shorter term to maturity;
- strips typically offer higher yields over T-Bills, GICs and term deposits, and over conventional bonds of the same issuer, term and credit rating;

³ A bond-like strip bond package has payment characteristics resembling a conventional bond, including regular fixed payments and a lump-sum payment at maturity. In contrast, an annuity-like strip bond package provides regular fixed payments but no lump-sum payment at maturity.

- the higher yield offered by strips reflects their greater price volatility. Like conventional bonds, the price of a strip is inversely related to its yield. Thus, when prevailing interest rates rise, strip prices fall, and vice versa. However, the rise or fall of strip prices is typically more extreme than with conventional bonds of the same issuer, term and credit rating. The primary reason for this greater volatility is that no interest is paid in respect of a strip bond prior to its maturity;
- unlike conventional bonds that trade in \$1,000 increments, strips may be purchased in \$1 multiples above the minimum investment amount, thereby enabling a holder to purchase a strip for any desired face value amount above the minimum investment amount; and
- strips are less liquid than conventional bonds of the same issuer, term and credit rating: there may not be a secondary market for certain strips and strip bond packages, and there is no requirement or obligation for investment dealers or financial institutions to maintain a secondary market for strips sold by or through them; as a result, purchasers should generally be prepared to hold a strip to maturity, since they may be unable to sell it—or only able to sell it at a significant loss—prior to maturity.

Dealer Mark-ups and Commissions

When purchasing or selling a strip bond or a strip bond package, the prospective purchaser or seller should inquire about applicable commissions (mark-ups or mark-downs) when executing the trade through an investment dealer or financial institution, since such commissions will reduce the effective yield (if buying) or the net proceeds (if selling). Investment dealers must make reasonable efforts to ensure the aggregate price, inclusive of any mark-up or mark-down, is fair and reasonable taking into consideration all reasonable factors. Commissions quoted by investment dealers generally range between \$0.25 to \$1.50 per \$100 of maturity amount of the strip, with commissions typically at the higher end of this range for small transaction amounts, reflecting the higher relative costs associated with processing small trades.

The table below illustrates the after-commission yield to a strip holder with different terms to maturity and assuming a before-commission yield of 5.5%. All of the yield numbers are semi-annual. For example, a strip bond with a term to maturity of one year and a commission of 25 cents per \$100 of maturity amount has an after-commission yield of 5.229%. The before-commission cost of this particular strip bond will be \$94.72 per \$100 of maturity amount while the after-commission cost will be \$94.97 per \$100 of maturity amount. In contrast, a strip bond with a term to maturity of 25 years and a commission of \$1.50 per \$100 of maturity amount has an after-commission yield of 5.267%. The before-commission cost of this particular strip bond will be \$25.76 per \$100 of maturity amount while the after-commission cost will be \$27.26 per \$100 of maturity amount.⁴

⁴ The purchase price of a strip bond may be calculated as follows:

$$\text{Purchase Price} = \text{Maturity (Par) Value} / (1 + y/2)^{2n}$$

where “y” is the applicable yield (before or after commission) and “n” is the number of years until maturity. For example, the purchase price (per \$100 of maturity value) for a strip bond that has a yield of 5.5% and 25 years until maturity is: $100/(1+0.0275)^{50} = \$25.76$.

| Commission or dealer mark-up amount (per \$100 of maturity amount) | Term to maturity in years and yield after commission or dealer mark-up (assuming a yield before commission of 5.5%) | | | | | |
|--|---|--------|--------|--------|--------|--------|
| | 1 | 2 | 5 | 10 | 15 | 25 |
| \$0.25 | 5.229% | 5.357% | 5.433% | 5.456% | 5.462% | 5.460% |
| \$0.75 | 4.691% | 5.073% | 5.299% | 5.368% | 5.385% | 5.382% |
| \$1.50 | 3.892% | 4.650% | 5.100% | 5.238% | 5.272% | 5.267% |

Prospective purchasers or sellers of strips should ask their investment dealer or financial institution about the bid and ask prices for strips and may wish to compare the yield to maturity of the strip, calculated after giving effect to any applicable mark-up or commission, against the similarly calculated yield to maturity of a conventional interest-bearing debt security.

Secondary Market and Liquidity

Strips may be purchased or sold through investment dealers and financial institutions on the “over-the-counter” market rather than on an exchange. Where there is an active secondary market, a strip may be sold by a holder prior to maturity at the prevailing market price in order to realize a capital gain or to access funds. However, liquidity may be limited for certain strip bonds and strip bond packages, and, as noted above, investment dealers and financial institutions are not obligated to maintain a secondary market for strips sold by or through them. **As a result, there can be no assurance that a market for particular strip bonds or strip bond packages will be available at any given time, and investors should generally be prepared to hold strips to maturity or run the risk of taking a loss.**

Other Risk Considerations

Potential purchasers of strips should conduct their own research into the term, yield, payment obligations and particular features of a strip prior to purchase. While not an exhaustive list, you may wish to consider some of the following potential risks:

Credit risk of the issuer – strips represent a direct payment obligation of the government or corporate issuer, thus any change to an issuer’s credit rating or perceived credit worthiness may affect the market price of a strip, and the impact may be more severe than the impact on conventional bonds of the same issuer.

Interest rate risk – if interest rates rise, the market value of a strip will go down, and this drop in market value will typically be more severe than the drop in market value for the corresponding conventional bond from the same issuer for the same term and yield. If interest rates rise above

the yield of the strip at the time of purchase, the market value of the strip may fall below the original price of the strip.

Market and liquidity risk – strips are not immune to market or liquidity risks and may have specific terms and conditions that apply in the event of a market disruption or liquidity event. If liquidity is low, it may be difficult to sell a strip prior to maturity and there may be large spreads between the bid and ask prices. **There can be no assurance that a market for particular strip bonds or strip bond packages will be available at any given time.**

Currency risk – strips may pay out in a currency other than Canadian dollars. Currency fluctuations may enhance, nullify or exacerbate your investment gains or losses.

Component risk – you should ensure that you understand and are comfortable with the underlying components, terms, risks and features of a strip bond or strip bond package prior to purchase. For example, strips may be derived from asset-backed securities or callable or retractable bonds, and may have features such as inflation indexation or structured payments.

Price volatility – strips are generally subject to greater price volatility than conventional bonds of the same issuer, term and credit rating, and will typically be subject to greater price fluctuations in response to changes to interest rates, credit ratings and liquidity and market events. The table below shows the impact that prevailing interest rates can have on the price of a strip. For example, as indicated in the table below, an increase in interest rates from 6% to 7% will cause the price of a 5 year strip bond with a maturity value of \$100 to fall by 4.73%—a larger percentage drop than for a \$100 5 year traditional bond, whose price would fall only 4.16%, assuming the same increase in interest rates.

Market Price Volatility

| Bond Type | Market Price | Market yield | Price with rate drop to 5% | Price change | Price with rate increase to 7% | Price change |
|--------------------|--------------|--------------|----------------------------|--------------|--------------------------------|--------------|
| 6% 5 Year Bond | \$100.00 | 6.00% | \$104.38 | + 4.38% | \$95.84 | - 4.16% |
| 5 Year Strip Bond | \$74.41 | 6.00% | \$78.12 | + 4.99% | \$70.89 | - 4.73% |
| 6% 20 Year Bond | \$100.00 | 6.00% | \$112.55 | + 12.55% | \$89.32 | - 10.68% |
| 20 Year Strip Bond | \$30.66 | 6.00% | \$37.24 | + 21.49% | \$25.26 | -17.61% |

Custodial Arrangements

Due to the high risk of forgery, money laundering and similar illegal activities—and the costs associated with such risks—with physical strips and bearer instruments, most investment dealers and financial institutions will only trade or accept transfer of book-based strips. CDS Clearing and Depository Services Inc. (“CDS”) provides strip bond services, including book-based custodial services for strips and underlying bonds. Custodian banks or trust companies may also create and take custody of strips that are receipt securities, and may permit holders to obtain a registered certificate or take physical delivery of the underlying coupon(s) or residue(s). However, if the holder decides to take physical delivery, he or she should be aware of the risks,

including the risk of lost ownership, associated with holding a bearer security which cannot be replaced. In addition, the holder should be aware that the secondary market for physical strips may be more limited than for book-based strips due to the risks involved. Investors in strip components held by and at CDS are not entitled to a physical certificate if the strips are Book Entry Only.

Canadian Income Tax Summary

The Canadian income tax consequences of purchasing strip bonds and strip bond packages are complex. Purchasers of strip bonds and strip bond packages should refer questions to the Canada Revenue Agency (<http://www.cra-arc.gc.ca/>) or consult their own tax advisors for advice relating to their particular circumstances.

The following is only a general summary regarding the taxation of strip bonds and strip bond packages under the *Income Tax Act (Canada)* (the “Tax Act”) for purchasers who are residents of Canada and hold their strip bonds and strip bond packages as capital property for purposes of the Tax Act. The following does not constitute legal advice.

Qualified Investments

Strip bonds and strip bond packages that are issued or guaranteed by the Government of Canada or issued by a province or territory of Canada are “qualified investments” under the Tax Act and are therefore eligible for purchase by trusts governed by registered retirement savings plans, registered retirement income funds, registered education savings plans, deferred profit sharing plans, registered disability savings plans and tax-free savings accounts (“Registered Plans”). Depending on the circumstances, strip bonds issued by corporations may also be “qualified investments” for Registered Plans.

Annual Taxation of Strip Bonds

The Canada Revenue Agency takes the position that strip bonds are a “prescribed debt obligation” within the meaning of the Tax Act. Consequently, a purchaser will be required to include in income in each year a notional amount of interest, notwithstanding that no interest will be paid or received in the year. Strips may therefore be more attractive when purchased and held in non-taxable accounts, such as self-directed Registered Plans, pension funds and charities.

In general terms, the amount of notional interest deemed to accrue each year will be determined by using the interest rate which, when applied to the total purchase price (including any dealer mark-up or commission) and compounded at least annually, will result in a cumulative accrual of notional interest from the date of purchase to the date of maturity equal to the amount of the discount from face value at which the strip bond was purchased.

For individuals and certain trusts, the required accrual of notional interest in each year is generally only up to the anniversary date of the issuance of the underlying bond. For example, if a strip bond is purchased on February 1 of a year and the anniversary date of the issuance of the underlying bond is June 30, only five months of notional interest accrual will be required in the year of purchase. However, in each subsequent year, notional interest will be required to be accrued from July 1 of that year to June 30 of the subsequent year (provided that the strip bond is still held on June 30 of the subsequent year).

In some circumstances the anniversary date of the issuance of the underlying bond may not be readily determinable. In these circumstances individual investors may wish to consider accruing notional interest each year to the end of the year instead of to the anniversary date.

A corporation, partnership, unit trust or any trust of which a corporation or partnership is a beneficiary is required for each taxation year to accrue notional interest to the end of the taxation year and not just to an earlier anniversary date in the taxation year.

Disposition of Strip Bonds Prior To Maturity

A purchaser who disposes of a strip bond prior to, or at, maturity, is required to include in the purchaser's income for the year of disposition notional interest accrued to the date of disposition that was not previously included in the purchaser's income as interest. If the amount received on a disposition exceeds the total of the purchase price and the amount of all notional interest accrued and included in income, the excess will be treated as a capital gain. If the amount received on disposition is less than the total of the purchase price and the amount of all notional interest accrued and included in income, the difference will be treated as a capital loss.

Strip Bond Packages

For tax purposes, a strip bond package is considered a series of separate strip bonds with the income tax consequences as described above applicable to each such component of the strip package. Thus a purchaser of a strip bond package will normally be required to make a calculation in respect of each component of the strip bond package and then aggregate such amounts to determine the notional interest accrued on the strip bond package. As an alternative, in cases where the strip bond package is issued at or near par and is kept intact, the Canada Revenue Agency will accept tax reporting that is consistent with reporting for ordinary bonds (i.e., reported on a T5 tax slip as accrued interest where it is matched by cash flow), including no obligation to report premium or discount amortization where the strip bond package is subsequently traded on the secondary market.

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