POLICY STATEMENT

RESPECTING HYBRID PRODUCTS
DERIVATIVES ACT

Purpose

A hybrid product is defined in the *Derivatives Act* (the "Act") as "an instrument, contract or security that combines elements of derivatives and securities." Examples of these products include principal protected and non-principal protected notes whose return at maturity is linked to a portfolio of securities, an index or an index basket.

It is important to clearly establish the legal regime applicable to hybrid products. To do so, a test is provided in section 4 of the Act intended to determine the regime governing this type of product.

A hybrid product is presumed to be predominantly a security where three conditions are satisfied.

This Policy Statement is intended to provide guidance on application of the test.

Payment of purchase price

Subparagraph 1 of the second paragraph of section 4 is as follows:

"(1) the offeror receives payment of the purchase price on the delivery of the hybrid product."

This condition does not necessarily imply that the product is fully payable upon issue. Several payments may be made for certain products. The issuer retains a certain control over the product while payments are made, and the purchaser takes possession of the product upon final payment.

Additional payments

Subparagraph 2 of the second paragraph of section 4 stipulates that:

"(2) the purchaser is under no obligation to make any additional payment beyond the purchase price as a margin deposit, margin, settlement or other such amount during the life of the hybrid product or at maturity."

Under this condition, the holder is in no way obligated to make additional payments for other purposes during the life of the hybrid product or at maturity.

This second condition thus excludes any hybrid product used to purchase, in consideration of a fixed amount, a related underlying interest.

Consequently, the purchase of a hybrid product that is a security does not entail any payment by the purchaser other than the purchase price. The purchaser is therefore not subject to margin calls, unlike purchasers of derivatives, who are required to meet such calls, failing which their positions may be liquidated.

Margin requirement

Subparagraph 3 of the second paragraph of section 4 is as follows:

"(3) the terms of the hybrid product do not include margin requirements based on a market value of its underlying interest."

Under this third condition, the product's terms do not include any margin requirement based on the market value of the underlying interest. The offeror therefore has no obligation in this regard.

Notes or structured notes

Consequently, a note or structured note where the return is based on an underlying interest, whether an index, a securities portfolio or other underlying asset, that meets the three conditions set out in section 4 of the Act is deemed to be a security. The current applicable regulatory framework governing such notes remains unchanged under the Act.

For information purposes, following are some examples taken from SEDAR of hybrid products that will continue to be governed by the *Securities Act*, given that they meet the conditions set out in the *Derivatives Act*:

- Notes whose return at maturity is linked to the price increase of a reference portfolio or to an index (payable in full at issue, callable, not retractable);

- Capital at risk notes (payable in full at issue, payments to holders: partial repayments of capital based on ordinary distributions from an income trust portfolio);

- 6-year partially capital protected notes (payable in full at issue);

- Principal Protected Equity Index-Linked "Booster" Notes;

- Interest coupons and notes without coupons based on debt securities of an issuer.

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