



**AUTORITÉ
DES MARCHÉS
FINANCIERS**

GUIDELINE ON PRINCIPAL PROTECTED NOTES

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Introduction

Over the past few years, principal protected notes (“PPNs”) have become increasingly complex, with various risk/return profiles. At present, a broad range of underlying assets are associated with PPNs, such as unmanaged investments (e.g., baskets of shares, bonds, currencies) and actively managed funds (e.g., mutual funds). The risks, fees and potential return of these financial instruments may not be transparent and prove difficult to understand for consumers.

In this light, the AMF expects all disclosures made by an institution to a consumer in accordance with this guideline to be made in language that is clear and simple and in a manner that is not misleading.

Pursuant to the powers conferred on it under the various laws¹ it administers, the AMF sets out its expectations regarding institutions’ legal requirement to adhere to sound commercial practices.² The AMF provides this guideline to financial services cooperatives as well as trust and savings companies that offer PPNs to consumers, thereby clearly laying out its expectations with regard to the information to be disclosed to consumers and how and when this information should be communicated.

The AMF’s expectations set out in this Guideline are harmonized with federal regulations *Principal Protected Notes Regulations*.³

Definition

In this Guideline, unless the context indicates otherwise, a **principal protected note** is a financial instrument that is issued by an institution to a consumer that:

- provides for one or more payments to be made by the institution that is determined, in whole or in part, by reference to an index or reference point, including:
 - the market price of a security, commodity, investment fund or other financial instrument; or
 - the exchange rate between any two currencies; and
- provides that the principal amount that the institution is obligated to repay at or before the note’s maturity is equal to or more than the total paid by the consumer for the note.

A principal protected note does not include a financial instrument that specifies that the interest or return on the instrument is solely determined on the basis of a fixed rate of interest or return or a variable rate of interest or return that is calculated from the institution’s prime lending rate or bankers’ acceptance rate.

¹ *Act respecting financial services cooperatives*, CQLR, c. C-67.3, section 565.1; *Deposit institution and deposit protection act*, CQLR, c. I-13.2.2, section 42.2; *Trust companies and savings companies Act*, CQLR, c. S-29.02, section 254.

² *Act respecting financial services cooperatives*, CQLR, c. C-67.3, section 66.1; *Deposit institution and deposit protection act*, CQLR, c. I-13.2.2, section 28.11. *Trust companies and savings companies Act*, CQLR, c. S-29.02, section 34.

³ *Principal Protected Notes Regulations* (SOR/2008-180).

1. Disclosure before purchase

The AMF expects consumers to have any information that is likely to influence their decision to invest in a principal protected note.

Subject to the specific terms and conditions set out in item 2, the AMF expects an institution to provide the consumer, at least two days before entering into an agreement for the issuance of a PPN, with a synopsis of the following information orally, by means of a person who is knowledgeable about the terms and conditions of the note, and in writing:

- the term of the note, and how and when the principal is to be repaid and the interest, if any, is to be paid;
- any charges and their impact on the interest payable;
- how interest is accrued, and any limitations in respect of the interest payable;
- any risks associated with the note, including, if applicable, the risk that no interest may accrue;
- the distinction between PPNs and fixed-rate investments with respect to the levels of risk and return;
- the circumstances in which a PPN could be an appropriate investment;
- the terms and conditions of any secondary market offered by the institution;
- if applicable:
 - the fact that the note relates to a deposit that is not guaranteed by the AMF, using the statement under section 37 of the *Regulation respecting the application of the Deposit Insurance Act*;⁴
 - whether the note may be redeemed before its maturity and, if so, that redemption before maturity may result in the consumer receiving less than the principal amount;
 - whether the consumer has the right to rescind the agreement for the purchase of a PPN and, if so, how he can exercise that right;
 - whether the note provides that the institution may amend the note and, if so, in what circumstances; and
 - whether the manner in which the note is structured or administered may place the institution in a conflict of interest;
- any other information that could reasonably be expected to affect a consumer's decision to invest in the PPN; and
- the fact that the information referred to in item 3.1 is available on request and that the information referred to in item 3.2 is also available on request after the PPN is issued.

If the institution provides the written disclosure by mail, the AMF will consider the disclosure to have been provided five business days after the postmark date.

⁴ *Deposit institution and deposit protection act*, CQLR, c. A-26, r. 1.

2. Specific terms and conditions

2.1 Agreement entered into in person

The AMF expects that the oral and written disclosure referred to in item 1 may be provided at any time before entering into the agreement for the issuance of a PPN if the institution and the consumer expressly consent to it and the agreement is entered into in person.

2.2 Agreement entered into by electronic means

2.2.1 Agreement without right of rescission

The AMF expects that the agreement for the issuance of a PPN entered into by electronic means may be made without the oral disclosure referred to in item 1. However, the institution should, at least two days before entering into the agreement, provide the written disclosure referred to in item 1 of this Guideline and disclose to the consumer the telephone number of a person who is knowledgeable about the terms and conditions of the note.

2.2.2 Agreement with right of rescission

If the agreement to issue a PPN is entered into by electronic means and it allows the consumer to rescind the purchase within two or more days after the day on which the agreement is entered into, the AMF expects the institution to make at a minimum the written disclosure referred to in item 1 at least two days before entering into the agreement.

Furthermore, the AMF expects the institution to disclose to the consumer, before, or without delay after, entering into the agreement, the telephone number of a person who is knowledgeable about the terms and conditions of the note. However, if disclosure of the contact information for such person is provided after entering into the agreement, the time period of at least two days given to the consumer for rescinding the agreement should only begin to elapse starting on the day following such disclosure.

2.3 Agreement entered into by telephone with right of rescission

If the agreement to issue a PPN is entered into by telephone and it allows the consumer to rescind the purchase within two or more days after the day on which the agreement is entered into, the AMF expects the institution to make the oral disclosure referred to in item 1 at least two days before entering into the agreement.

The AMF further expects the institution to provide, before entering into the agreement or without delay thereafter, the written disclosure referred to in item 1. However, if such written disclosure is provided after entering into the agreement, the time period of at least two days given to the consumer for rescinding the agreement should only begin to elapse starting on the day following such disclosure.

3. Additional disclosure

3.1 Detailed information on principal protected notes

The AMF expects the institution to disclose the information referred to in item 1 respecting the PPNs offered by it in a full and complete manner on its websites and in written format to be sent to any person who requests it.

3.2 Additional information following the issuance of a principal protected note

3.2.1 Information about the value note

If a consumer makes an inquiry concerning the value of his PPN on a specified day, the AMF expects the institution to disclose the following information to him without delay:

- the net asset value of the PPN on the specified day and how that value is related to the interest payable under the PPN;
- the last available measure, before the specified day, of the index or reference point on which the interest on the PPN is determined and how that measure is related to the interest payable under the note.

3.2.2 Information about early redemption of the note

Before redeeming or purchasing a PPN before its maturity at the request of a consumer, the AMF expects an institution to disclose to the consumer:

- a) the value of the note on the last business day before the day that the consumer requests the purchase or redemption, or the value of the note based on the last available measure of the index or reference point on which the interest is determined;
- b) the amount of any penalty or charge;
- c) the net amount that the consumer would have received for the purchase or redemption, after deducting the amount referred to in paragraph b) from the value of the note referred to in paragraph a); and,
- d) when and how the value of the PPN will be calculated, and the fact that the value of the note may differ from the value referred to in paragraph a) above.

3.2.3 Information about amendments to the note

Before making an amendment to a PPN that may have an impact on the interest payable under the note, the AMF expects the institution to disclose the amendment, and its potential impact on the interest payable, in writing to the consumers concerned. If it is not possible to disclose this information in advance, the AMF expects the institution to make such disclosure without delay after the amendment is made.

3.2.4 Information about reference points

If a PPN ceases to be linked to an index or reference point that was to be used to determine the interest payable under the PPN and, as a result, no interest will be paid, the AMF expects the institution to disclose that fact to the consumer without delay.

4. Advertisement content

In each of its advertisements for PPNs, the AMF expects an institution to disclose clearly how the public may obtain information about the notes.

In any advertisement that refers to features of PPNs or the interest payable under them, the AMF expects an institution to also disclose:

- the manner in which interest is to be accrued, and any limitations in respect of the interest payable;
- if the advertisement gives an example of a situation in which interest would be payable, an example of another situation in which no interest would be payable;
- if the advertisement gives an example of a situation in which interest would be payable that is in addition to any minimum interest that is guaranteed, an example of another situation in which only the minimum interest would be payable; and
- if applicable, the fact that the notes relate to deposits that are not guaranteed by the AMF, using the statement under section 37 of the *Regulation respecting the application of the Deposit Insurance Act*⁵.

The AMF expects an institution that uses past market performance in an advertisement for a PPN to represent that performance fairly and, if hypothetical examples are used, the assumptions underlying those examples must be realistic and must be disclosed in the advertisement. The AMF also expects the institution to disclose in the advertisement that past market performance is not an indicator of future market performance.

⁵ *Deposit institution and deposit protection act*, CQLR, c. I-13.2.2, r. 1