NEW BRUNSWICK SECURITIES COMMISSION
COMMISSION DES VALEURS MOBILIÈRES DU NOUVEAU-BRUNSWICK

NOTICE OF AMENDMENTS TO NEW BRUNSWICK SECURITIES COMMISSION LOCAL RULE 91-501 *DERIVATIVES*

Introduction

On 21 June 2010, the New Brunswick Securities Commission (Commission) made amendments to Commission Local Rule 91-501 *Derivatives* (LR 91-501). Subject to Ministerial approval requirements, the proposed amendments to LR 91-501 will come into force on 1 September 2010 in New Brunswick.

Background

LR 91-501 came into force in New Brunswick on 28 September 2009. On the same date, the *Securities Act*, S.N.B 2004, c. S.5-5 was also amended to clarify the Commission's regulatory authority and to provide a legislative framework for regulating derivatives in New Brunswick. LR 91-501 requires registration or the use of an investment dealer/portfolio manager in order to trade in derivatives.

Subsequent to the adoption of LR 91-501, the Commission received inquiries from industry in regards to the interpretation of subsection 3(2) of the LR 91-501. This subsection provides a registration exemption for trades when each party to the trade is a qualified party acting as principal.

In order to increase clarity in LR 91-501, the Commission proposes to amend the wording in subsection 3(2). Amendments will emphasize that the registration exemption only applies in the case where both parties to a transaction are qualified parties acting as principal.

Proposed Amendments to LR 91-501

On 29 March 2010, the Commission approved publication for comment of proposed amendments to LR 91-501. The Commission published the proposed amendments to LR 91-501 on the Commission's website on 6 April 2010 and in the 21 April 2010 edition of The Royal Gazette. The deadline for receiving comments was 7 June 2010. No comments were received.

This Notice contains the amendment instrument to LR 91-501 under Appendix "A" along with a blackline version of LR 91-501 reflecting the changes when compared to the version of LR 91-501 that is currently in force under Appendix "B".

Questions

Questions may be referred to:

Kevin Hoyt
Director, Regulatory Affairs & Chief Financial Officer
New Brunswick Securities Commission
Tel: 506-643-7691
Fax: 506-658-3059
Email: kevin.hoyt@nbsc-cvmnb.ca

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Amendments to
New Brunswick Securities Commission
Local Rule 91-501 *Derivatives*

1 This Instrument amends Local Rule 91-501 Derivatives.

2 Subsection 3(2) is amended by striking out "if the derivative is bought or sold by" ***and substituting*** "where each party to the trade is".

3 This Instrument comes into force on 1 September 2010.

NEW BRUNSWICK SECURITIES COMMISSION
COMMISSION DES VALEURS MOBILIÈRES DU NOUVEAU-BRUNSWICK

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NEW BRUNSWICK SECURITIES COMMISSION
LOCAL RULE 91-501

DERIVATIVES

DEFINITIONS AND INTERPRETATION

1(1) In this rule

"alternative trading system" means a published market that

(a) is not an exchange, and

(b) does not

(i) provide, directly, or through one or more subscribers, a guarantee of a two-sided derivatives market on a continuous basis,

(ii) set requirements governing the conduct of subscribers, other than conduct in respect of the trading by those subscribers on the marketplace, and

(iii) discipline subscribers other than by exclusion from participation in the marketplace; (*système de négociation parallèle)*

"*Act*" means the *Securities Act*, SNB c. S-5.5, as amended. (*Loi)*

"derivative" means

(a) an exchange contract,

(b) an option, swap, futures contract or any other contract or instrument, that is not an exchange contract, whose market price, value or delivery or payment obligations are derived from, referenced to or based on an underlying interest, or

(c) any other contract or instrument determined to be a derivative on the basis of criteria determined by the Commission. (*derivé ou instrument derivé*)

"hedging" means the entering into of a derivatives transaction or a series of derivatives transactions, and the maintaining of the position or positions resulting from the transaction or series of transactions if

(a) the intended effect of the transaction or series of transactions is

(i) to offset or reduce the risk related to fluctuations in the value of an underlying interest or a position, or of a group of underlying interests or positions, or

(ii) to substitute a risk to one currency for a risk to another currency, provided the aggregate amount of currency risk to which the hedger is exposed is not increased by the substitution,

(b) the transaction or series of transactions results in a high degree of negative correlation between changes in the value of the underlying interest or position or group of underlying interests or positions being hedged and changes in the value of the derivatives with which the value of the underlying interests or positions is hedged, and

(c) there are reasonable grounds to believe that the transaction or series of transactions no more than offsets the effect of price changes in the underlying interest or position, or group of underlying interests or positions, being hedged. (*couverture*)

"information processor" means any person or company that receives and provides information under National Instrument 21-101 *Marketplace Operation* and has filed Form 21-101F5 *Initial Operation Report for Information Processor*. (*agence de traitement de l'information*)

"NI 31-103" means National Instrument 31-103 *Registration Requirements and Exemptions*. (*NC 31-103*)

"NI 45-106" means National Instrument 45-106 *Prospectus and Registration Exemptions*. (*NC 45-106*)

"NI 81-104" means National Instrument 81-104 *Commodity Pools*. (*NC 81-104*)

"NI 81-106" means National Instrument 81-106 *Investment Fund Continuous Disclosure*. (*NC 81-106*)

"published market" means an exchange, alternative trading system or other derivatives market that

(a) constitutes or maintains a system for bringing together buyers and sellers of derivatives,

(b) brings together the orders of multiple derivatives buyers and sellers, and

(c) uses a defined, non-discretionary process under which

(i) the orders interact with each other, and

(ii) the derivatives buyers and sellers entering the orders agree to the terms of the trade. (*marché orrganisé*)

"qualified party" means

(a) the Government of Canada or a jurisdiction of Canada, or any crown corporation, agency or wholly-owned entity of the Government of Canada or a jurisdiction of Canada,

(b) a municipality, municipal corporation, public board or commission in Canada or other similar municipal administration, metropolitan community or school board,

(c) a bank listed in Schedule I, II or III of the *Bank Act* (Canada),

(d) an insurance company licensed under the *Insurance Act*,

(e) a credit union as defined in the *Credit Unions Act*,

(f) a loan company or trust company licensed under the *Loan and Trust Companies Act*,

(g) the Business Development Bank of Canada, established under the *Business Development Bank of Canada Act* (Canada),

(h) a pension fund regulated by the Office of the Superintendent of Financial Institutions established by the

Office of the Superintendent of Financial Institutions Act (Canada), the Office of the Superintendent of Pensions pursuant to the *Pension Benefits Act*, whose investment policy provides for or authorizes the use of derivatives, or an entity that is analogous in form and function established under legislation applicable outside New Brunswick,

(i) a person organized in another jurisdiction of Canada or a foreign jurisdiction that is analogous to any of the persons referred to in paragraphs (c) to (h),

(j) an investment dealer or portfolio manager within the meaning of NI 31-103 who is registered under the *Act*, an investment fund manager within the meaning of NI 31-103 who is registered under the *Act* and who is acting on behalf of an investment fund described in paragraph (m) or paragraph (n), or a person authorized to act as such or to exercise similar functions under the equivalent legislation applicable outside New Brunswick,

(k) a registered individual within the meaning of NI 31-103 who is an employee or representative of a person described in paragraph (j) or an individual who has ceased to be so registered within the last three years,

(l) a person who establishes

(i) that the person has the requisite knowledge and experience to evaluate the information provided to the person about derivatives, the suitability of the proposed derivatives strategies, and the characteristics of the derivatives to be traded on the person's behalf,

(ii) that, at all times, the person has net assets equal to or in excess of 5 million dollars, and

(iii) that, at all times, the person has at the person's disposal net assets sufficient to fulfill the person's delivery or payment obligations under the terms of derivatives to which the person is party, in light of the positions held in the person's account and the orders the person is seeking to have executed,

(m) an investment fund whose investment policy includes or authorizes the use of derivatives, that distributes or has distributed its securities under a prospectus for which the Commission or another authority empowered to issue receipts under the securities legislation of a province or territory of Canada has issued a receipt, or that distributes or has distributed its securities exclusively to

(i) a person who is a qualified party, at the time of the distribution,

(ii) a person who purchases or has purchased securities of the fund in order to make a minimum amount investment or an additional investment under the conditions prescribed by regulation, or

(iii) a person described in subparagraph (i) or (ii) who acquires or has acquired securities of the fund for the purposes of reinvesting in the fund, under the conditions prescribed by regulation,

(n) an investment fund that is advised by an adviser or operated by an investment fund manager, within the meaning of NI 31-103,

(o) a charity registered under the *Income Tax Act* (Canada) that, with respect to the trade in question, has used the services of an adviser within the meaning of NI 31-103,

(p) a person all of whose security holders, except the holders of voting securities required by law to be held by directors, are qualified parties,

(q) a person who, because of the person's hedging activities

(i) is exposed to one or more risks attendant upon those activities, including supply, credit, exchange and environmental risks and the risk related to fluctuations in the price of an underlying interest, and

(ii) seeks to hedge that risk by engaging in a derivatives transaction, or a series of derivatives transactions, where the underlying interest is directly associated with that risk or a related underlying interest, or

(r) a person considered by the Commission to be a qualified party. (*partie qualifiée*)

"regulated entity" means an exchange, alternative trading system, another published market, clearing agency, regulation services provider, information processor, self-regulatory organization or any person the Commission, where it considers it necessary for the proper operation of the market, considered to be a regulated entity. (*entité réglementée*)

"trade" has the same meaning as contained in the *Act*, and includes

(a) entering into a derivative as a counterparty,

(b) facilitating, enabling, assisting, or executing a transaction of a derivative as an intermediary, principal, or agent,

(c) the receipt, by a registrant, of an instruction from a counterparty to participate in a transaction of a derivative, and

(d) an act, advertisement, solicitation, conduct, or negotiation, directly or indirectly in furtherance of any of the activities specified in paragraphs (a) to (c). (*opération*)

1(2) Unless otherwise defined, terms used in this rule that are defined in the *Act* have the same meaning as in the *Act*.

APPLICATION

2(1) This rule applies to any trade of a derivative.

2(2) A trade in a derivative is exempted from Parts 6, 7, 8, 9 and 11.1 of the *Act*.

2(3) Each of the following is deemed not to be a derivative:

(a) an insurance or annuity contract issued by an insurer holding a license under the *Insurance Act* or under other insurance legislation in Canada,

(b) a conventional convertible security,

(c) an asset-backed security,

(d) an index participation unit,

(e) a strip bond,

(f) a capital, equity dividend or income share of a subdivided equity or fixed income security,

(g) a conventional warrant or subscription right,

(h) a special warrant,

(i) an option or other instrument or security whose value is derived from, referenced to or based on the value or market price of a security granted under a compensation plan,

(j) a contract for difference,

(k) a mutual fund or a unit thereof,

(l) an 'investment fund' as defined in NI 81-106 or a unit thereof,

(m) a 'non-redeemable investment fund' as defined in NI 81-106 or a unit thereof,

(n) a 'labour sponsored or venture capital fund' as defined in NI 81-106 or a unit thereof,

(o) a 'scholarship plan' as defined in NI 81-106 or a unit thereof,

(p) a 'commodity pool' as defined in NI 81-104 or a unit thereof,

(q) a contract that

(i) is not an exchange contract,

(ii) contains an obligation to make or take future delivery of a commodity, and

(iii) does not allow for cash settlement in place of future delivery, and

(r) any other instrument considered by the Commission not to be a derivative.

2(4) The requirements in subsections 5(1) and 5(2) of this rule do not apply to any client who is a qualified party.

TRADING DERIVATIVES

3(1) Subject to subsections 3(2) and 3(3), no person shall trade in a derivative unless the person is registered

(a) as an investment dealer under NI 31-103,

(b) as a portfolio manager under NI 31-103, or

(c) as a representative under NI 31-103 of a registered firm described in paragraph (a) or (b).

3(2) The registration requirements in subsection (1) do not apply in respect of a trade in a derivative where each party to the trade is a qualified party acting as principal.

Deleted: if the derivative is bought or sold by

3(3) A person may trade in a derivative without being registered if the person

(a) is not engaged in the business of trading derivatives as a principal or agent, and

(b) does not hold himself, herself or itself out as engaging in the business of trading in derivatives as a principal or agent.

REGULATED ENTITIES

4 No regulated entity may trade in derivatives unless it is

(a) recognized by the Commission under section 35 of the *Act*, or

(b) permitted by the Commission, subject to such terms and conditions as the Commission considers appropriate.

RISK INFORMATION DOCUMENT

5(1) Prior to opening an account that will be used, in the case of an investment dealer, to trade in derivatives and, in the case of a portfolio manager, to advise on derivatives, an investment dealer or portfolio manager must

(a) provide each prospective client with a copy of Form 91-501F1 *Risk Information Document*, and

(b) obtain from each prospective client a written acknowledgement that the client has received a copy of Form 91-501F1 *Risk Information Document*.

5(2) An investment dealer or portfolio manager may satisfy the requirements in paragraphs 5(1)(a) and 5(1)(b) by using an alternate risk information document that is approved by the Executive Director.

EXEMPTION

6 The Executive Director may grant an exemption from this rule, in whole or in part, subject to such conditions or restrictions as may be imposed in the exemption.

EFFECTIVE DATE

7 This rule comes into force on 28 September 2009.

NEW BRUNSWICK SECURITIES COMMISSION
COMMISSION DES VALEURS MOBILIÈRES DU NOUVEAU-BRUNSWICK

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NEW BRUNSWICK SECURITIES COMMISSION
FORM 91-501F1

RISK INFORMATION DOCUMENT

Risk Information Document for Derivatives

This brief document does not disclose all of the risks and other significant aspects of trading in futures contracts, options or other derivatives. In light of the risks, you should undertake such transactions only if you understand the nature of the contracts (and contractual relationships) into which you are entering and the extent of your exposure to risk. Trading in derivatives is not suitable for many members of the public. You should carefully consider whether trading is appropriate for you in light of your experience, objectives, financial resources and other relevant circumstances.

Futures Contracts

1. Effect of “Leverage” or “Gearing”

Transactions in futures contracts carry a high degree of risk. The amount of initial margin is small relative to the value of the futures contract so that transactions are “leveraged” or “geared”. A relatively small market movement will have a proportionately larger impact on the funds you have deposited or will have to deposit: this may work against you as well as for you. You may sustain a total loss of initial margin funds and any additional funds deposited with the firm to maintain your position. If the market moves against your position or margin levels are increased, you may be called upon to pay substantial additional funds on short notice to maintain your position. If you fail to comply with a request for additional funds within the time prescribed, your position may be liquidated at a loss and you will be liable for any resulting deficit.

2. Risk-reducing Orders or Strategies

The placing of certain orders (e.g. "stop-loss" order, where permitted under local law, or "stop-limit" orders) which are intended to limit losses to certain amounts may not be effective because market conditions may make it impossible to execute such orders. Strategies using combinations of positions, such as "spread" and "straddle" positions may be as risky as taking simple "long" or "short" positions.

Options

3. Variable Degree of Risk

Transactions in options carry a high degree of risk. Purchasers and sellers of options should familiarize themselves with the type of option (i.e. put or call) which they contemplate trading and the associated risks. You should calculate the extent to which the value of the options must increase for your position to become profitable, taking into account the premium and all transaction costs.

The purchaser of options may offset or exercise the options or allow the options to expire. The exercise of an option results either in a cash settlement or in the purchaser acquiring or delivering the underlying interest. If the option is on a futures contract, the purchaser will acquire a futures position with associated liabilities for margin (see the section on Futures Contracts above). If the purchased options expire worthless, you will suffer a total loss of your investment which will consist of the option premium plus transaction costs. If you are contemplating purchasing deep-out-of-the-money options, you should be aware that the chance of such options becoming profitable ordinarily is remote.

Selling ("writing" or "granting") an option generally entails considerably greater risk than purchasing options. Although the premium received by the seller is fixed, the seller may sustain a loss well in excess of that amount. The seller will be liable for additional margin to maintain the position if the market moves unfavourably. The seller will also be exposed to the risk of the purchaser exercising the option and the seller will be obligated to either settle the option in cash or to acquire or deliver the underlying interest. If the option is on a futures contract, the seller will acquire a position in a future with associated liabilities for margin (see the section on Futures Contracts above). If the option is "covered" by the seller holding a corresponding position in the underlying interest or a futures contract or another option, the risk may be reduced. If the option is not covered, the risk of loss can be unlimited.

Certain exchanges in some jurisdictions permit deferred payment of the option premium, exposing the purchaser to liability for margin payments not exceeding the amount of the premium. The purchaser is still subject to the risk of losing the premium and transaction costs. When the option is exercised or expires, the purchaser is responsible for any unpaid premium outstanding at that time.

Additional Risks Common to Derivatives

4. Terms and Conditions of Contracts

You should ask the firm with which you deal about the terms and conditions of the specific futures contracts, options or other derivatives which you are trading and associated obligations (e.g. the circumstances under which you may become obligated to make or take delivery of the underlying interest and, in respect of options, expiration dates and restrictions on the time for exercise).

Under certain circumstances the specifications of outstanding contracts (including the exercise price of an option) may be modified by the exchange or clearing house to reflect changes in the underlying interest.

5. Suspension or Restriction of Trading and Pricing Relationships

Market conditions (e.g. liquidity) and/or the operation of the rules of certain markets (e.g. the suspension of trading in any contract or contract month because of price limits or "circuit breakers") may increase the risk of loss by making it difficult or impossible to effect transactions or liquidate/offset positions. If you have sold options, this may increase the risk of loss.

Further, normal pricing relationships between the underlying interest and the derivative may not exist. This can occur when, for example, the futures contract underlying the option is subject to price limits while the option is not.

The absence of an underlying reference price may make it difficult to judge "fair" value.

6. Deposited Cash and Property

You should familiarize yourself with the protections accorded money or other property you deposit for domestic and foreign transactions, particularly in the event of a firm insolvency or bankruptcy. The extent to which you may recover your money or property may be governed by specific legislation or local rules. In some jurisdictions, property which had been specifically identifiable as your own will be prorated in the same manner as cash for purposes of distribution in the event of a shortfall.

7. Commission and Other Charges

Before you begin to trade, you should obtain a clear explanation of all commissions, fees and other charges for which you will be liable. These charges will affect your net profit (if any) or increase your loss.

8. Transactions in Other Jurisdictions

Transactions on markets in other jurisdictions, including markets formally linked to a domestic market, may expose you to additional risk. Such markets may be subject to regulation which may offer different or diminished investor protection. Before you trade you should inquire about any rules relevant to your particular transactions. Your local regulatory authority will be unable to compel the enforcement of the rules of regulatory authorities or markets in other jurisdictions where your transactions have been effected. You should ask the firm with which you deal for details about the types of redress available in both your home jurisdiction and other relevant jurisdictions before you start to trade.

9. Currency Risks

The profit or loss in transactions in foreign currency-denominated derivatives (whether they are traded in your own or another jurisdiction) will be affected by fluctuations in currency rates where there is a need to convert from the currency denomination of the derivative to another currency.

10. Trading Facilities

Most open-outcry and electronic trading facilities are supported by computer-based component systems for the order-routing, execution, matching, registration or clearing of trades. As with all facilities and systems, they are vulnerable to temporary disruption or failure. Your ability to recover certain losses may be subject to limits on liability imposed by the system provider, the market, the clearing house and/or member firms. Such limits may vary; you should ask the firm with which you deal for details in this respect.

11. Electronic Trading

Trading on an electronic trading system may differ not only from trading in an open-outcry market but also from trading on other electronic trading systems. If you undertake transactions on an electronic trading system, you will be exposed to risks associated with the system, including the failure of hardware and software. The result of any system failure may be that your order is either not executed according to your instructions or is not executed at all. Your ability to recover certain losses which are particularly attributable to trading on a market using an electronic trading system may be limited to less than the amount of your total loss.

12. Off-exchange Transactions

In some jurisdictions, and only then in restricted circumstances, firms are permitted to effect off-exchange transactions. The firm with which you deal may be acting as your counterparty to the transaction. It may be difficult or impossible to liquidate an existing position, to assess the value, to determine a fair price or to assess the exposure to risk. For these reasons, these transactions may involve increased risks.

Off-exchange transactions may be less regulated or subject to a separate regulatory regime. Before you undertake such transactions, you should familiarize yourself with applicable rules.