

or subject to the rules of the board of trade.

(Approved by the Office of Management and Budget under control number 3038-0007)

(Secs. 2(a)(1)(A), 4c(b), 4c(c), and 8a of the Commodity Exchange Act, 7 U.S.C. 2, 6c(b), 6c(c) and 12a; secs. 2(a)(1)(A), 4c, 4d, 4f, and 8a(5) (7 U.S.C. 2(a)(1)(A), 6c, 6d, 6f and 12a(5) (1982)))

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§33.5 Application for designation as a contract market for the trading of commodity options.

(a) Any board of trade desiring to be designated as a contract market for a particular commodity option contract shall make application to the Commission and accompany the same with a written showing that it meets the conditions set forth in, and provides all the information and materials required by, these regulations.

(b) Subject to the provisions of the Act and these regulations, in the event of a refusal to designate any board of trade as a contract market for a particular commodity option, such board of trade shall be afforded notice and an opportunity for a hearing on the record: *Provided*, That pending the conclusion of any such hearing, such designation shall not be granted.

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[46 FR 54529, Nov. 3, 1981, as amended at 46 FR 63036, Dec. 30, 1981; 52 FR 779, Jan. 9, 1987]

§33.6 Suspension or revocation of designation as a contract market for the trading of commodity options.

The Commission may, after notice and opportunity for a hearing on the record, suspend or revoke the designation of any board of trade as a contract market in a commodity option for which it is designated if the Commission determines that:

(a) The board of trade, or any director, officer, agent, or employee thereof,

is violating or has violated any of the provisions of this part.

(b) Cause exists which, under §33.2 or §33.4, would warrant the denial of a designation;

(c) The option market is not used on more than an occasional basis for other than speculative purposes by producers, processors, merchants or commercial users engaged in handling or utilizing the commodity (including the products, by-products or source commodity thereof) underlying an option, in interstate commerce; or

(d) Option trading on the contract market in that contract is contrary to the protection of option customers or the underlying futures or cash markets, or is otherwise contrary to the public interest: *Provided*, That pending completion of any proceeding under this section, the Commission may suspend such designation for the duration of the proceedings, if in the Commission's judgment, the continuation of such trading presents a substantial risk to the public interest.

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§33.7 Disclosure.

(a)(1) Except as provided in §1.65 of this chapter, no futures commission merchant, or in the case of an introduced account no introducing broker, may open or cause the opening of a commodity option account for an option customer, other than for a customer specified in §1.55(f) of this chapter, unless the futures commission merchant or introducing broker first:

(i) Furnishes the option customer with a separate written disclosure statement as set forth in this section or another statement approved under §1.55(c) of this chapter and set forth in appendix A to §1.55 which the Commission finds satisfies this requirement, or includes either such statement in a booklet containing the customer account agreement and other disclosure statements required by Commission rules; *provided, however*, that if the statement contained in §33.7 is used it

must follow the statement required by §1.55; and

(ii) Subject to the provisions of §1.55(d) of this chapter, receives from the option customer an acknowledgment signed and dated by the option customer that he received and understood the disclosure statement.

(2) The disclosure statement and the acknowledgment shall be retained by the futures commission merchant or the introducing broker in accordance with §1.31 of this chapter. The disclosure statement must be as set forth in paragraph (b) of this section, typed or printed in type of not less than 10-point size, and, where indicated, in all capital letters.

(b) The disclosure statement must read as follows:

OPTIONS DISCLOSURE STATEMENT

BECAUSE OF THE VOLATILE NATURE OF THE COMMODITIES MARKETS, THE PURCHASE AND GRANTING OF COMMODITY OPTIONS INVOLVE A HIGH DEGREE OF RISK. COMMODITY OPTION TRANSACTIONS ARE NOT SUITABLE FOR MANY MEMBERS OF THE PUBLIC. SUCH TRANSACTIONS SHOULD BE ENTERED INTO ONLY BY PERSONS WHO HAVE READ AND UNDERSTOOD THIS DISCLOSURE STATEMENT AND WHO UNDERSTAND THE NATURE AND EXTENT OF THEIR RIGHTS AND OBLIGATIONS AND OF THE RISKS INVOLVED IN THE OPTION TRANSACTIONS COVERED BY THIS DISCLOSURE STATEMENT.

BOTH THE PURCHASER AND THE GRANTOR SHOULD KNOW WHETHER THE PARTICULAR OPTION IN WHICH THEY CONTEMPLATE TRADING IS AN OPTION WHICH, IF EXERCISED, RESULTS IN THE ESTABLISHMENT OF A FUTURES CONTRACT (AN "OPTION ON A FUTURES CONTRACT") OR RESULTS IN THE MAKING OR TAKING OF DELIVERY OF THE ACTUAL COMMODITY UNDERLYING THE OPTION (AN "OPTION ON A PHYSICAL COMMODITY"). BOTH THE PURCHASER AND THE GRANTOR OF AN OPTION ON A PHYSICAL COMMODITY SHOULD BE AWARE THAT, IN CERTAIN CASES, THE DELIVERY OF THE ACTUAL COMMODITY UNDERLYING THE OPTION MAY NOT BE REQUIRED AND THAT, IF THE OPTION IS EXERCISED, THE OBLIGATIONS OF THE PURCHASER AND GRANTOR WILL BE SETTLED IN CASH.

A PERSON SHOULD NOT PURCHASE ANY COMMODITY OPTION UNLESS HE IS ABLE TO SUSTAIN A TOTAL LOSS OF THE PREMIUM AND TRANSACTION COSTS OF PURCHASING THE OPTION. A PERSON

SHOULD NOT GRANT ANY COMMODITY OPTION UNLESS HE IS ABLE TO MEET ADDITIONAL CALLS FOR MARGIN WHEN THE MARKET MOVES AGAINST HIS POSITION AND, IN SUCH CIRCUMSTANCES, TO SUSTAIN A VERY LARGE FINANCIAL LOSS.

A PERSON WHO PURCHASES AN OPTION SHOULD BE AWARE THAT IN ORDER TO REALIZE ANY VALUE FROM THE OPTION, IT WILL BE NECESSARY EITHER TO OFFSET THE OPTION POSITION OR TO EXERCISE THE OPTION. IF AN OPTION PURCHASER DOES NOT UNDERSTAND HOW TO OFFSET OR EXERCISE AN OPTION, THE PURCHASER SHOULD REQUEST AN EXPLANATION FROM THE FUTURES COMMISSION MERCHANT OR THE INTRODUCING BROKER. CUSTOMERS SHOULD BE AWARE THAT IN A NUMBER OF CIRCUMSTANCES, SOME OF WHICH WILL BE DESCRIBED IN THIS DISCLOSURE STATEMENT, IT MAY BE DIFFICULT OR IMPOSSIBLE TO OFFSET AN EXISTING OPTION POSITION ON AN EXCHANGE.

THE GRANTOR OF AN OPTION SHOULD BE AWARE THAT, IN MOST CASES, A COMMODITY OPTION MAY BE EXERCISED AT ANY TIME FROM THE TIME IT IS GRANTED UNTIL IT EXPIRES. THE PURCHASER OF AN OPTION SHOULD BE AWARE THAT SOME OPTION CONTRACTS MAY PROVIDE ONLY A LIMITED PERIOD OF TIME FOR EXERCISE OF THE OPTION.

THE PURCHASER OF A PUT OR CALL IS SUBJECT TO THE RISK OF LOSING THE ENTIRE PURCHASE PRICE OF THE OPTION—THAT IS THE PREMIUM PAID FOR THE OPTION PLUS ALL TRANSACTION COSTS.

THE COMMODITY FUTURES TRADING COMMISSION REQUIRES THAT ALL CUSTOMERS RECEIVE AND ACKNOWLEDGE RECEIPT OF A COPY OF THIS DISCLOSURE STATEMENT BUT DOES NOT INTEND THIS STATEMENT AS A RECOMMENDATION OR ENDORSEMENT OF EXCHANGE-TRADED COMMODITY OPTIONS.

(1) Some of the risks of option trading.

Specific market movements of the underlying future or underlying physical commodity cannot be predicted accurately.

The grantor of a call option who does not have a long position in the underlying futures contract or underlying physical commodity is subject to risk of loss should the price of the underlying futures contract or underlying physical commodity be higher than the strike price upon exercise or expiration of the option by an amount greater than the premium received for granting the call option.

The grantor of a call option who has a long position in the underlying futures contract or underlying physical commodity is subject

to the full risk of a decline in price of the underlying position reduced by the premium received for granting the call. In exchange for the premium received for granting a call option, the option grantor gives up all of the potential gain resulting from an increase in the price of the underlying futures contract or underlying physical commodity above the option strike price upon exercise or expiration of the option.

The grantor of a put option who does not have a short position in the underlying futures contract or underlying physical commodity (e.g., commitment to sell the physical) is subject to risk of loss should the price of the underlying futures contract or underlying physical commodity decrease below the strike price upon exercise or expiration of the option by an amount in excess of the premium received for granting the put option.

The grantor of a put option on a futures contract who has a short position in the underlying futures contract is subject to the full risk of a rise in the price in the underlying position reduced by the premium received for granting the put. In exchange for the premium received for granting a put option on a futures contract, the option grantor gives up all of the potential gain resulting from a decrease in the price of the underlying futures contract below the option strike price upon exercise or expiration of the option. The grantor of a put option on a physical commodity who has a short position (e.g., commitment to sell the physical) is subject to the full risk of a rise in the price of the physical commodity which must be obtained to fulfill the commitment reduced by the premium received for granting the put. In exchange for the premium, the grantor of a put option on a physical commodity gives up all the potential gain which would have resulted from a decrease in the price of the commodity below the option strike price upon exercise or expiration of the option.

(2) *Description of commodity options.* Prior to entering into any transaction involving a commodity option, an individual should thoroughly understand the nature and type of option involved and the underlying futures contract or physical commodity. The futures commission merchant or introducing broker is required to provide, and the individual contemplating an option transaction should obtain:

(i) An identification of the futures contract or physical commodity underlying the option and which may be purchased or sold upon exercise of the option or, if applicable, whether exercise of the option will be settled in cash;

(ii) The procedure for exercise of the option contract, including the expiration date and latest time on that date for exercise. (The latest time on an expiration date when an option may be exercised may vary; there-

fore, option market participants should ascertain from their futures commission merchant or their introducing broker the latest time the firm accepts exercise instructions with respect to a particular option.);

(iii) A description of the purchase price of the option including the premium, commissions, costs, fees and other charges. (Since commissions and other charges may vary widely among futures commission merchants and among introducing brokers, option customers may find it advisable to consult more than one firm when opening an option account.);

(iv) A description of all costs in addition to the purchase price which may be incurred if the commodity option is exercised, including the amount of commissions (whether termed sales commissions or otherwise), storage, interest, and all similar fees and charges which may be incurred;

(v) An explanation and understanding of an option grantor's initial margin requirement and obligation to provide additional margin in connection with such an option position, or a position in a futures contract, if applicable;

(vi) A clear explanation and understanding of any clauses in the option contract and of any items included in the option contract explicitly or by reference which might affect the customer's obligations under the contract. This would include any policy of the futures commission merchant or the introducing broker or rule of the exchange on which the option is traded that might affect the customer's ability to fulfill the option contract or to offset the option position in a closing purchase or closing sale transaction (for example, due to unforeseen circumstances that require suspension or termination of trading); and

(vii) If applicable, a description of the effect upon the value of the option position that could result from limit moves in the underlying futures contract.

(3) *The mechanics of option trading.* Before entering into any exchange-traded option transaction, an individual should obtain a description of how commodity options are traded.

Option customers should clearly understand that there is no guarantee that option positions may be offset by either a closing purchase or closing sale transaction on an exchange. In this circumstance, option grantors could be subject to the full risk of their positions until the option position expires, and the purchaser of a profitable option might have to exercise the option to realize a profit.

For an option on a futures contract, an individual should clearly understand the relationship between exchange rules governing option transactions and exchange rules governing the underlying futures contract. For example, an individual should understand

what action, if any, the exchange will take in the option market if trading in the underlying futures market is restricted or the futures prices have made a "limit move."

The individual should understand that the option may not be subject to daily price fluctuation limits while the underlying futures may have such limits, and, as a result, normal pricing relationships between options and the underlying future may not exist when the future is trading at its price limit. Also, underlying futures positions resulting from exercise of options may not be capable of being offset if the underlying future is at a price limit.

(4) *Margin requirements.* Commodity Futures Trading Commission rules require the purchaser of an option to pay the full option premium when the option position is opened.

Before granting an option, an individual should fully understand the applicable margin requirements, and particularly should be aware of the obligation to put up additional margin money in the case of adverse market moves.

(5) *Profit potential of an option position.* An option customer should carefully calculate the price which the underlying futures contract or underlying physical commodity would have to reach for the option position to become profitable. This price would include the amount by which the underlying futures contract or underlying physical commodity would have to rise above or fall below the strike price to cover the sum of the premium and all other costs incurred in entering into and exercising or closing (offsetting) the commodity option position.

Also, an option customer should be aware of the risk that the futures price prevailing at the opening of the next trading day may be substantially different from the futures price which prevailed when the option was exercised. Similarly, for options on physicals that are cash settled, the physicals price prevailing at the time the option is exercised may differ substantially from the cash settlement price that is determined at a later time. Thus, if a customer does not cover the position against the possibility of underlying commodity price change, the realized price upon option exercise may differ substantially from that which existed at the time of exercise.

(6) *Deep-out-of-the-money options.* A person contemplating purchasing a deep-out-of-the-money option (that is, an option with a strike price significantly above, in the case of a call, or significantly below, in the case of a put, the current price of the underlying futures contract or underlying physical commodity) should be aware that the chance of such an option becoming profitable is ordinarily remote.

On the other hand, a potential grantor of a deep-out-of-the-money option should be aware that such options normally provide

small premiums while exposing the grantor to all of the potential losses described in section (1) of this disclosure statement.

(7) *Glossary of terms.* (i) *Contract market.* Any board of trade (exchange) located in the United States which has been designated by the Commodity Futures Trading Commission to list a futures contract or commodity option for trading.

(ii) *Exchange-traded option; put option; call option.* The options discussed in this disclosure statement are limited to those which may be traded on a contract market. These options (subject to certain exceptions) give an option purchaser the right to buy in the case of a call option, or to sell in the case of a put option, a futures contract or the physical commodity underlying the option at the stated strike price prior to the expiration date of the option. Each exchange-traded option is distinguished by the underlying futures contract or underlying physical commodity, strike price, expiration date, and whether the option is a put or a call.

(iii) *Underlying futures contract.* The futures contract which may be purchased or sold upon the exercise of an option on a futures contract.

(iv) *Underlying physical commodity.* The commodity of a specific grade (quality) and quantity which may be purchased or sold upon the exercise of an option on a physical commodity.

(v) *Class of options.* A put or a call covering the same underlying futures contract or underlying physical commodity.

(vi) *Series of options.* Options of the same class having the same strike price and expiration date.

(vii) *Exercise price.* See strike price.

(viii) *Expiration date.* The last day when an option may be exercised.

(ix) *Premium.* The amount agreed upon between the purchaser and seller for the purchase or sale of a commodity option.

(x) *Strike price.* The price at which a person may purchase or sell the underlying futures contract or underlying physical commodity upon exercise of a commodity option. This term has the same meaning as the term "exercise price."

(xi) *Short option position.* See opening sale transaction.

(xii) *Long option position.* See opening purchase transaction.

(xiii) *Types of options transactions—(A) Opening purchase transaction.* A transaction in which an individual purchases an option and thereby obtains a long option position.

(B) *Opening sale transaction.* A transaction in which an individual grants an option and thereby obtains a short option position.

(C) *Closing purchase transaction.* A transaction in which an individual with a short option position liquidates the position. This is accomplished by a closing purchase transaction for an option of the same series as the

option previously granted. Such a transaction may be referred to as an offset transaction.

(D) *Closing sale transaction.* A transaction in which an individual with a long option position liquidates the position. This is accomplished by a closing sale transaction for an option of the same series as the option previously purchased. Such a transaction may be referred to as an offset transaction.

(xiv) *Purchase price.* The total actual cost paid or to be paid, directly or indirectly, by a person to acquire a commodity option. This price includes all commissions and other fees, in addition to the option premium.

(xv) *Grantor, writer, seller.* An individual who sells an option. Such a person is said to have a short position.

(xvi) *Purchaser.* An individual who buys an option. Such a person is said to have a long position.

(c) Prior to the entry of the first commodity option transaction for the account of an option customer, a futures commission merchant or an introducing broker, or the person soliciting or accepting the order therefor, must provide an option customer with all of the information required under the disclosure statement, including the commissions, costs, fees and other charges to be incurred in connection with the commodity option transaction and all costs to be incurred by the option customer if the commodity option is exercised: *Provided*, That the futures commission merchant or the introducing broker, or the person soliciting or accepting the order therefor, must provide current information to an option customer if information provided previously has become inaccurate.

(d) Prior to the entry into a commodity option transaction on or subject to the rules of a contract market, each option customer or prospective option customer shall, to the extent the following amounts are known or can reasonably be approximated, be informed by the person soliciting or accepting the order therefor of the amount of the strike price and the premium (and any mark-ups thereon, if applicable).

(e) A futures commission merchant and an introducing broker must establish the necessary procedures and supervision to ensure compliance with the requirements of this section.

(f) This section does not relieve a futures commission merchant or an in-

roducing broker from any obligation under the Act or the regulations thereunder, including the obligation to disclose all material information to existing or prospective option customers even if the information is not specifically required by this section.

(g) For purposes of this section, neither a futures commission merchant nor an introducing broker shall be deemed to be an option customer.

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EFFECTIVE DATE NOTE: At 63 FR 8571, Feb. 20, 1998, §33.7 was amended by revising paragraph (a)(1) introductory text, effective Apr. 21, 1998. For the convenience of the user, the superseded text is set forth as follows:

§ 33.7 Disclosure.

(a)(1) Except as provided in §1.65 of this chapter, no futures commission merchant, or in the case of an introduced account no introducing broker, may open or cause the opening of a commodity option account for an option customer unless the futures commission merchant or introducing broker first:

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§ 33.8 Promotional material.

Each futures commission merchant and each introducing broker shall retain, in accordance with §1.31 of this chapter, all promotional material it provides, directly or indirectly, to option customers as well as the true source of authority for the information contained therein.

[48 FR 35303, Aug. 3, 1983]

§ 33.9 Unlawful activities.

It shall be unlawful for any person:

(a) Required to be registered with the Commission in accordance with the Act or these regulations expressly or impliedly to represent that the Commission, by declaring effective the registration of such person or otherwise, has directly or indirectly approved such person, or any commodity option transaction solicited or accepted by such person;