(g) *Exemption.* (1) The provisions of §§ 3.13, 32.2, 32.11 of this chapter and this section shall not apply to a commodity option offered by a person which has a reasonable basis to believe that:

(i) The option is offered to a producer, processor, or commercial user of, or a merchant handling, the commodity which is the subject of the commodity option transaction, or the products or byproducts thereof;

(ii) Such producer, processor, commercial user or merchant is offered or enters into the commodity option transaction solely for purposes related to its business as such; and

(iii) Each party to the option contract has a net worth of not less than $10 million or the party's obligations on the option are guaranteed by a person which has a net worth of $10 million and has a majority ownership interest in, is owned by, or is under common ownership with, the party to the option.

(2) Provided, however, that § 32.9 continues to apply to such option transactions.

[64 FR 68017, Dec. 6, 1999]

PART 33—REGULATION OF DOMESTIC EXCHANGE-TRADED COMMODITY OPTION TRANSACTIONS

Sec.

AUTHORITY: 7 U.S.C. 1a, 2, 4, 6, 6a, 6b, 6c, 6d, 6e, 6f, 6g, 6h, 6i, 6j, 6k, 6l, 6m, 6n, 6o, 7, 7a, 7b, 8, 9, 11, 12a, 12c, 13a, 13a–1, 13b, 19, and 21, otherwise noted.

SOURCE: 46 FR 54529, Nov. 3, 1981, unless otherwise noted.

§ 33.1 Definitions.

As used in this part:

(a) *Purchase price* means the total amount paid or to be paid, directly or indirectly, by a person to acquire a commodity option.

(b) *Promotional material* includes: (1) Any text of a standardized oral presentation, or any communication for publication in any newspaper, magazine or similar medium, or for broadcast over television, radio, or other electronic medium, which is disseminated or directed to an option customer or prospective option customer concerning a commodity option transaction; (2) any standardized form of report, letter, circular, memorandum, or publication which is disseminated or directed to an option customer or prospective option customer; and (3) any other written material disseminated or directed to an option customer or prospective option customer for the purpose of soliciting an option transaction, including any disclosure statement required by § 33.7.

§ 33.2 Applicability of Act and rules; scope of part 33.

(a) Except as otherwise specified in this part and unless the context otherwise requires:

(1) Each board of trade designated, or applying for designation, by the Commission as a contract market for the purpose of trading commodity options pursuant to this part shall be deemed for such purpose to be a "board of trade," "exchange," and a "contract market" and, with respect to commodity option transactions conducted pursuant to such designation, shall comply with and be subject to all of the provisions of the Act relating to boards of trade, exchanges, or contract markets as though such provisions were set forth herein; and

(2) The provisions of sections 1a, 2(a)(1), 2(a)(8)(B), 4, 4a, 4c(a), 4d, 4e, 4f, 4g, 4h, 4i, 4j, 4k, 4m, 4n, 5, 5a(a), 5b, 6, 6a, 6b, 6c, 7, 8(a)–(e), 8a, 8b, 8c, and 16 of the Act shall apply to commodity option transactions that are subject to the requirements of this part as though such provisions were set forth herein

and included specific references to commodity option transactions. Nothing contained in this section shall be construed to confer designation as a contract market absent issuance of an order of the Commission so designating an applicant board of trade.

(b) The provisions of this part apply to commodity option transactions except for transactions which are governed by part 32 of this chapter.

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

[46 FR 54529, Nov. 3, 1981, as amended at 46 FR 63036, Dec. 30, 1981; 47 FR 57016, Dec. 22, 1982; 59 FR 5526, Feb. 7, 1994]

§ 33.3 Unlawful commodity option transactions.

(a) It shall be unlawful for any person to offer to enter into, enter into, confirm the execution of, or maintain a position in, any commodity option transaction subject to the provisions of this part unless the commodity option involved is traded (1) on or subject to the rules of a contract market which has been designated to trade commodity options pursuant to this part and (2) by or through a member thereof in accordance with the provisions of this part.

(b) It shall be unlawful for:

(1) Any person to solicit or accept orders from an option customer (other than in a clerical capacity) for any commodity option transaction, or to supervise any person or persons so engaged, unless such person is:

(i) Registered as a futures commission merchant under the Act, and either:

(A) Is a member of the contract market on which the option is traded, or

(B) Is a member of a futures association registered under section 17 of the Act which has adopted rules which the Commission has approved under section 17(j) of the Act and, in addition to the requirements of that section, has determined to provide for the regulation of the commodity option related activity of its member futures commission merchants in a manner equivalent to that required of contract markets under these regulations; or

(ii) Registered as an introducing broker under the Act, and either:

(A) Is a member of a futures association registered under section 17 of the Act which has adopted rules which the Commission has approved under section 17(j) of the Act, or is a member of a contract market which has adopted rules which the Commission has approved under section 5a(a)(12) of the Act, and which, in addition to the requirements of those sections, has determined to provide for the regulation of the commodity option related activity of its member introducing brokers in a manner equivalent to that required of contract markets with respect to their member futures commission merchants under these regulations; or

(B) Is operating pursuant to a guarantee agreement, and the futures commission merchant which has signed such agreement is a member of a self-regulatory organization that has adopted rules which the Commission has approved that provide for the regulation of the commodity option related activity of the introducing broker in a manner equivalent to that required of contract markets with respect to their member futures commission merchants under these regulations; or

(iii) An individual registered as an associated person of a specified person registered as a futures commission merchant or as an introducing broker under the Act who meets the requirements of paragraphs (b)(1)(i) or (b)(1)(ii), respectively, of this section, and such registration shall not have expired, been suspended (and the period of suspension has not expired) or been revoked.

(2) Any person registered or required to be registered as a futures commission merchant or as an introducing broker under the Act to permit another person to become or remain associated with such person as a partner, officer, employee, agent or representative (or in any status or position involving similar functions) in any capacity involving the solicitation or acceptance of an order from an option customer (other than in a clerical capacity) for any commodity option transaction, or the supervision of any person or persons so engaged, if such person knows or should have known that such other

person is or was not registered as required by this part or that such registration has expired, been suspended (and the period of suspension has not expired) or been revoked.

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[46 FR 54529, Nov. 3, 1981, as amended at 46 FR 63036, Dec. 30, 1981; 47 FR 57016, Dec. 22, 1982; 48 FR 35301, Aug. 3, 1983; 59 FR 5526, Feb. 7, 1994]

§ 33.4 Designation as a contract market for the trading of commodity options.

The Commission may designate any board of trade located in the United States as a contract market for the trading of options on contracts of sale for future delivery or for options on physicals in any commodity regulated under the Act, when the applicant complies with and carries out the requirements of the Act (as provided in § 33.2), the regulations in this part, and the following conditions and requirements with respect to the commodity option for which the designation is sought:

(a) Such board of trade—

(1) Applies for designation as a contract market for the purpose of trading ''put'' and/or ''call'' options which:

(i) Are not capable of being transferred, assigned or otherwise disposed of other than on or subject to the rules of the board of trade; and

(ii) With respect to options on futures contracts, may be exercised only by the establishment, by book entry, in the clearing organization of positions in the underlying futures contract.

(2) [Reserved]

(3) If designation for the trading of options on futures contracts is sought, is designated as a contract market for the underlying contract of sale for future delivery which is the subject of the option for which designation is sought, and submits, if so requested by the Commission, the information called for by § 1.50 of this chapter (relating to continued compliance with the conditions and requirements for designation as a contract market) for the specified futures contract underlying the option for which the designation is sought, and the applicant complies with the conditions and requirements for designation as a contract market for such contract for future delivery as set forth in sections 5 and 5a(a) of the Act and as set forth in these regulations.

(4) In the case of a contract market which is requesting designation for the trading of options on physicals for which it is designated as a contract market for contracts of sale for future delivery or for options on futures contracts, submits, if so requested by the Commission, the information called for by § 1.50 of this chapter (relating to continued compliance with the conditions and requirements for designition as a contract market) for that specified futures contract and/or options on that futures contract, and the applicant complies with the conditions and requirements for designation as a contract market for such contract for future delivery as set forth in sections 5 and 5a(a) of the Act and as set forth in these regulations.

(5) Demonstrates that:

(i) The commodity option for which it is requesting designation is likely to serve a legitimate economic purpose;

(ii)–(iii) [Reserved]

(iv) If designation for the trading of options on physicals is sought and thereafter for the purpose of demonstrating continued compliance with the Act and these regulations:

(A) The cash market for the underlying physical exhibits sufficient liquidity such that the grantor and purchaser of the option have the opportunity to purchase or sell the underlying physical at its economic value in normal cash marketing channels;

(B) There exists an accurate and widely-disseminated price series for the underlying physical which is deliverable on the option contract;

(C) Trading of such options will not be disruptive of trading in the cash market for the underlying physical or of any futures contract; and

(D) The individual terms and conditions of the option contract conform to practices in the underlying cash market or are otherwise justified, including a demonstration that the terms and conditions of the option contract provide for a deliverable supply which is not conducive to price manipulation or distortion, consistent with a description of the cash market furnished by the board of trade.

(b) Such board of trade adopts rules which:

(1) Prescribe in regard to strike prices:

(i) The dollar amount of the intervals between strike prices;

(ii) The strike prices at which trading in a new option expiration will be introduced;

(iii) The point, in terms of the price of the underlying futures contract or underlying physical, at which a new strike price will be introduced in any option which is already trading;

(iv) [Reserved]

(2) Prescribe an expiration date of the option that is not less than one business day before the earlier of the last trading day or the first notice day of any futures contract on the same or a related commodity; *Provided, however,* That where the underlying futures contract is cash-settled, the option may expire simultaneously with the expiration of the futures contract.

(3) Require that upon exercise of each option, notification thereof be given to the option grantor.

(4) Require, with respect to all written option customer complaints, that each member futures commission merchant which engages in the offer or sale of commodity options regulated under this part:

(i) Retain all such complaints;

(ii) Make and retain a record of the date the complaint was received, the associated person who serviced, or the introducing broker who introduced, the account, a general description of the matter complained of, and what, if any, action was taken by the futures commission merchant in regard to the complaint; and

(5) Require each member futures commission merchant which engages in the offer or sale of option contracts regulated under this part to adopt and enforce written procedures pursuant to which it will be able to supervise adequately each option customer's account, including but not limited to, the solicitation of any such account: *Provided,* That as used in this paragraph (b)(5), the term ''option customer'' does not include another futures commission merchant.

(6) [Reserved]

(7) Require each member futures commission merchant which engages in the offer or sale of option contracts regulated under this part to enforce the disclosure requirements set forth in § 33.7.

(8)–(9) [Reserved]

(10) Prohibit fraudulent or high-pressure sales communications by member futures commission merchants relating to the offer or sale of option contracts regulated under this part.

(11) Establish appropriate criteria which are reasonably designed to secure performance, upon exercise, of the option contracts.

(c) Such board of trade establishes procedures and conducts sales practice audits of member futures commission merchants which engage in the offer or sale of option contracts regulated under this part. These sales practice audits must be of sufficient scope to enforce the contract market's rules, including imvestigation for the improper handling of discretionary accounts, inadequate internal supervision, fraudulent or high-pressure sales communications, compliance with disclosure requirements, improper handling and disposition of option customer complaints, and, where applicable, the futures commission merchant's offer or sale of deep-out-of-the-money options.

(d) A board of trade must submit an analysis and justification of the individual terms and conditions of the option contract. In determining whether to approve option contract terms and conditions, the Commission may consider the analysis and justification submitted for such terms and conditions, including, without limitation:

(1) [Reserved]

(2) The conditions precedent to the exercise of the commodity option and the method by which the option may be exercised;

(3) The nature of the clearing mechanism to be utilized for the commodity option, and the differences, if any, among the clearing mechanisms for options on futures contracts, options on physicals, and futures contracts;

(4) Specific notice periods, including the periods from the date notice of intent to exercise an option is given until exercise is accomplished;

(5) The default provisions and procedures of the commodity option, if any; and

(6) Permitted deviations from or substitutes for compliance with the terms and conditions set forth in paragraphs (d) (1) through (5) of this section.

(e) Such board of trade provides for the general quotation and dissemination of volume and last sale price information on a timely basis with respect to the commodity option for which designation is sought and with respect to the underlying futures contract.

(f) Such board of trade demonstrates that clearance and processing of option transactions on or subject to the rules of the board of trade will not adversely affect the clearance and processing of any transactions for future delivery on or subject to the rules of the board of trade.

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(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)))

[46 FR 54529, Nov. 3, 1981, as amended at 46 FR 63036, Dec. 30, 1981; 47 FR 57017, Dec. 22, 1982; 48 FR 786, Jan. 7, 1983; 48 FR 35302, Aug. 3, 1983; 49 FR 33644, Aug. 24, 1984; 49 FR 44893, Nov. 13, 1984; 51 FR 17474, May 13, 1986; 52 FR 779, Jan. 9, 1987; 56 FR 43697, Sept. 4, 1991; 57 FR 58978, Dec. 14, 1992; 58 FR 30703, May 27, 1993; 59 FR 5526, Feb. 7, 1994; 61 FR 2720, Jan. 29, 1996; 63 FR 18834, Apr. 16, 1998; 63 FR 32732, June 16, 1998]

§ 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.

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

[46 FR 54529, Nov. 3, 1981, as amended at 46 FR 63036, Dec. 30, 1981; 47 FR 57018, Dec. 22, 1982]

§ 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.

BOTH THE PURCHASER AND THE GRANTOR SHOULD KNOW WHETHER THE PARTICULAR OPTION IN WHICH THEY CONTEMPLATE TRADING IS SUBJECT TO A ''STOCK-STYLE'' OR ''FUTURES-STYLE'' SYSTEM OF MARGINING. UNDER A STOCK-STYLE MARGINING SYSTEM, A PURCHASER IS REQUIRED TO PAY THE FULL PURCHASE PRICE OF THE OPTION AT THE INITIATION OF THE TRANSACTION. THE PURCHASER HAS NO FURTHER OBLIGATION ON THE OPTION POSITION. UNDER A FUTURES-STYLE MARGINING SYSTEM, THE PURCHASER DEPOSITS INITIAL MARGIN AND MAY BE REQUIRED TO DEPOSIT ADDITIONAL MARGIN IF THE MARKET MOVES AGAINST THE OPTION POSITION. THE PURCHASER'S TOTAL SETTLEMENT VARIATION MARGIN OBLIGATION OVER THE LIFE OF THE OPTION, HOWEVER, WILL NOT EXCEED THE ORIGINAL OPTION PREMIUM, ALTHOUGH SOME INDIVIDUAL PAYMENT OBLIGATIONS AND/OR RISK MARGIN REQUIREMENTS MAY AT TIMES EXCEED THE ORIGINAL OPTION PREMIUM. IF THE PURCHASER OR GRANTOR DOES NOT UNDERSTAND HOW OPTIONS ARE MARGINED UNDER A STOCK-STYLE OR FUTURES-STYLE MARGINING SYSTEM, HE OR SHE SHOULD REQUEST AN EXPLANATION FROM THE FUTURES COMMISSION MERCHANT (''FCM'') OR INTRODUCING BROKER (''IB'').

A PERSON SHOULD NOT PURCHASE ANY COMMODITY OPTION UNLESS HE OR SHE 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 OR SHE IS ABLE TO MEET ADDITIONAL CALLS FOR MARGIN WHEN THE MARKET MOVES AGAINST HIS OR HER POSITION AND, IN

SUCH CIRCUMSTANCES, TO SUSTAIN A VERY LARGE FINANCIAL LOSS.

A PERSON WHO PURCHASES AN OPTION SUBJECT TO STOCK-STYLE MARGINING 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. OPTIONS SUBJECT TO FUTURES-STYLE MARGINING ARE MARKED TO MARKET, AND GAINS AND LOSSES ARE PAID AND COLLECTED DAILY. IF AN OPTION PURCHASER DOES NOT UNDERSTAND HOW TO OFFSET OR EXERCISE AN OPTION, THE PURCHASER SHOULD REQUEST AN EXPLANATION FROM THE FCM OR IB. 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 SUBJECT TO STOCK-STYLE OR FUTURES-STYLE MARGINING IS SUBJECT TO THE RISK OF LOSING THE ENTIRE PURCHASE PRICE OF THE OPTION—THAT IS, THE PREMIUM CHARGED 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; therefore, 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 the option margining system;

(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. An individual should know and understand whether the option he or she is contemplating trading is subject to a stock-style or futures-style system of margining. Stock-style margining requires the purchaser to pay the full option premium at the time of purchase. The purchaser has no further financial obligations, and the risk of loss is limited to the purchase price and transaction costs. Futures-style margining requires the purchaser to pay initial margin only at the time of purchase. The option position is marked to market, and gains and losses are collected and paid daily. The purchaser's risk of loss is limited to the initial option premium and transaction costs.

An individual granting options under either a stock-style or futures-style system of margining should understand that he or she may be required to pay additional margin in the case of adverse market movements.

(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. Under a stock-style margining system, 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. Under a future-style margining system, option positions would be marked to market, and gains and losses would be paid and collected daily, and an option position would become profitable once the variation margin collected exceeded the cost of entering the contract 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 introducing 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.

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

[46 FR 54529, Nov. 3, 1981, as amended at 46 FR 63036, Dec. 30, 1981; 48 FR 35302, Aug. 3, 1983; 49 FR 44893, Nov. 13, 1984; 51 FR 17475, May 13, 1986; 58 FR 17505, Apr. 5, 1993; 59 FR 34381, July 5, 1994; 63 FR 8571, Feb. 20, 1998; 63 FR 32732, June 16, 1998]

§ 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;

(b) In or in connection with an offer to enter into, the entry into, the confirmation of the execution of, or the maintenance of any commodity option transaction, expressly or impliedly to represent that compliance with the provisions of the Act or these regulations constitutes a guarantee of the fulfillment of the commodity option transaction;

(c) Upon acceptance of an order for a commodity option transaction, to fail unreasonably to secure prompt execution of such order or upon rejection of an order to fail to notify the person whose order has been rejected of such rejection;

(d) To manipulate or attempt to manipulate the market price of any commodity option on or subject to the rules of any contract market: *Provided, however*, That for purposes of this paragraph (d), any action taken by a contract market pursuant to a rule approved by the Commission or any emergency action which a contract market is permitted to take pursuant to the Act or these regulations shall not be deemed to be a manipulation; and

(e) Upon acceptance of an order for a commodity option transaction to bucket such order.

[46 FR 54529, Nov. 3, 1981; 46 FR 55925, Nov. 13, 1981]

§ 33.10 Fraud in connection with commodity option transactions.

It shall be unlawful for any person directly or indirectly:

(a) To cheat or defraud or attempt to cheat or defraud any other person;

(b) To make or cause to be made to any other person any false report or statement thereof or cause to be entered for any person any false record thereof;

(c) To deceive or attempt to deceive any other person by any means whatsoever

in or in connection with an offer to enter into, the entry into, the confirmation of the execution of, or the maintenance of, any commodity option transaction.

§33.11 Exemptions.

The Commission may, by order, upon written request or upon its own motion, exempt any person, either unconditionally or on a temporary or other conditional basis, from any provisions of this part, other than §§33.9 and 33.10, if it finds, in its discretion, that it would not be contrary to the public interest to grant such exemption.

[52 FR 29508, Aug. 10, 1987]

PART 34—REGULATION OF HYBRID INSTRUMENTS

AUTHORITY: 7 U.S.C. 2, 6, 6c and 12a.

SOURCE: 58 FR 5586, Jan. 22, 1993, unless otherwise noted.

§34.1 Scope.

The provisions of this part shall apply to any hybrid instrument which may be subject to the Act, and which has been entered into on or after October 23, 1974.

§34.2 Definitions.

(a) *Hybrid instruments.* Hybrid instrument means an equity or debt security or depository instrument as defined in §34.3(a)(1) with one or more commodity-dependent components that have payment features similar to commodity futures or commodity option contracts or combinations thereof.

(b) *Commodity-independent component.* Commodity-independent component means the component of a hybrid instrument, the payments of which do not result from indexing to, or calculation by reference to, the price of a commodity.

(c) *Commodity-independent value.* Commodity-independent value means the present value of the payments attributable to the commodity-independent component calculated as of the time of issuance of the hybrid instrument.

(d) *Commodity-dependent component.* A commodity-dependent component means a component of a hybrid instrument, the payment of which results from indexing to, or calculation by reference to, the price of a commodity.

(e) *Commodity-dependent value.* For purposes of application of Rule 34.3(a)(2), a commodity-dependent value means the value of a commodity dependent-component, which when decomposed into an option payout or payouts, is measured by the absolute net value of the put option premia with strike prices less than or equal to the reference price plus the absolute net value of the call option premia with strike prices greater than or equal to the reference price, calculated as of the time of issuance of the hybrid instrument.

(f) *Option premium.* Option premium means the value of an option on the referenced commodity of the hybrid instrument, and calculated using the same method as that used to determine the issue price of the instrument, or where such premia are not explicitly calculated in determining the issue price of the instrument, the value of such options calculated using a commercially reasonable method appropriate to the instrument being priced.

(g) *Reference price.* A reference price means a price nearest the current spot or forward price, whichever is used to price instrument, at which a commodity-dependent payment becomes non-zero, or, in the case where two potential reference prices exist, the price that results in the greatest commodity-dependent value.

§34.3 Hybrid instrument exemption.

(a) A hybrid instrument is exempt from all provisions of the Act and any person or class of persons offering, entering into, rendering advice or rendering other services with respect to such exempt hybrid instrument is exempt for such activity from all provisions of the Act (except in each case section 2(a)(1)(B)), provided the following terms and conditions are met:

(1) The instrument is:

(i) An equity or debt security within the meaning of section 2(1) of the Securities Act of 1933; or

(ii) A demand deposit, time deposit or transaction account within the meaning of 12 CFR 204.2 (b)(1), (c)(1) and (e),