

## COMMODITY FUTURES TRADING COMMISSION

### 17 CFR Parts 3, 32, and 33

RIN 3038-AD62

### Commodity Options

**AGENCY:** Commodity Futures Trading Commission.

**ACTION:** Final rule and interim final rule.

**SUMMARY:** The Commodity Futures Trading Commission ("Commission" or "CFTC") is issuing a final rule to repeal and replace the Commission's current regulations concerning commodity options. The Commission is also issuing an interim final rule (with a request for additional comment) that incorporates a trade option exemption into the final rules for commodity options (added § 32.3). For a transaction to be within the trade option exemption, the option, the offeror (seller), and the offeree (buyer), as applicable, must satisfy certain eligibility requirements, including that the option, if exercised, be physically settled, that the option seller meet certain eligibility requirements, and that the option buyer be a commercial user of the commodity underlying the option, and certain other regulatory conditions. Only comments pertaining to the interim final rule will be considered in any further action related to these rules.

**DATES:** *Effective date:* The effective date for this final rule and the interim final rule June 26, 2012.

*Comment date:* Comments on § 32.3, the interim final rule portion of this document, must be received on or before June 26, 2012.

*Compliance date:* For compliance dates for these final rules, see **SUPPLEMENTARY INFORMATION** at section IV(D), below.

**ADDRESSES:** You may submit comments, identified by RIN number 3038-AD62, by any of the following methods:

- *Agency Web site, via its Comments Online process:* <http://comments.cftc.gov>. Follow the instructions for submitting comments through the Web site.
- *Mail:* David A. Stawick, Secretary of the Commission, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street NW., Washington, DC 20581.
- *Courier:* Same as mail above.
- *Federal eRulemaking Portal:* <http://www.regulations.gov>. Follow the instructions for submitting comments. Please submit your comments using only one method.

All comments must be submitted in English, or if not, accompanied by an

English translation. Comments will be posted as received to <http://www.cftc.gov>. You should submit only information that you wish to make available publicly. If you wish the CFTC to consider information that you believe is exempt from disclosure under the Freedom of Information Act, a petition for confidential treatment of the exempt information may be submitted according to the procedures established in § 145.9 of the CFTC's regulations.<sup>1</sup>

The CFTC reserves the right, but shall have no obligation, to review, pre-screen, filter, redact, refuse or remove any or all of your submission from <http://www.cftc.gov> that it may deem to be inappropriate for publication, such as obscene language. All submissions that have been redacted or removed that contain comments on the merits of this action will be retained in the public comment file and will be considered as required under the Administrative Procedure Act and other applicable laws, and may be accessible under the Freedom of Information Act.

#### FOR FURTHER INFORMATION CONTACT:

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#### SUPPLEMENTARY INFORMATION:

##### Table of Contents

- I. Introduction
  - A. *Dodd-Frank Act*
  - B. *Notice of Proposed Rulemaking—February 3, 2011; Final Rule and Interim Final Rule*
- II. Commodity Options Background
  - A. *Commission's Plenary Statutory Authority Over Commodity Options*
  - B. *The NPRM Proposed an Overhaul of Existing Commodity Options Regulations*
- III. Comments on the Commodity Options Proposal in the NPRM
  - A. *Request for Comment on the NPRM*
  - B. *Summary of Comments on the NPRM*
    1. General Overview
    2. Comments on the Commodity Options Proposal
      - a. Whether the Definition of Swap Includes Commodity Options
      - b. Trade Option Exemption
      - c. Eligible Contract Participants and Trade Options
      - d. FERC-Regulated Transactions
      - e. Deleting the Dealer Option Provisions
      - f. Deleting the Agricultural Trade Option Provisions

- g. Options Fraud Provisions
- IV. Explanation of the Final Rule and Interim Final Rule for Commodity Options
  - A. *Introduction*
  - B. *Sections Unchanged From the NPRM*
  - C. *New Part 32*
    1. Final Rule
    2. Interim Final Rule; Trade Option Exemption
      - a. Exemption From General Swaps Rules
      - b. Offeror
      - c. Offeree
      - d. Physical Commodity Option
      - e. Trade Option Exemption Conditions
      - i. Recordkeeping Pursuant to Part 45
      - ii. Reporting Pursuant to Part 45
      - iii. Annual Notice Filing Alternative to Part 45 Reporting; Form TO
      - iv. Specific Request for Comment on Trade Option Reporting and/or Notice Filing Requirements
      - v. Swaps Large Trader Reporting; Position Limits
      - vi. SD/MSP Conditions
      - vii. Enforcement Provisions
      - viii. General Exemptive Authority Retained
    - D. *Effective Date; Compliance Date*
  - V. Interim Final Rule Matters
  - VI. Request for Comment on Interim Final Rule
  - VII. Related Matters
    - A. *Cost Benefit Considerations*
      1. Background
      2. Statutory Mandate To Consider the Costs and Benefits of the Commission's Action: CEA Section 15(a)
      3. Benefits and Costs of the Final Rule
        - a. Benefits
        - b. Costs
      4. Interim Final Rule Benefits and Costs
        - a. Benefits
        - b. Costs
        - c. Costs and Benefits as Compared to Alternatives
      5. Section 15(a) Factors (of the Final Rule and Interim Final Rule as a Whole)
        - a. Protection of Market Participants and the Public
        - b. Efficiency, Competitiveness, and Financial Integrity of the Markets
        - c. Price Discovery
        - d. Sound Risk Management Procedures
        - e. Other Public Interest Considerations
      6. Request for Comment on CBC in Connection With Interim Final Rule
    - B. *Regulatory Flexibility Analysis*
      1. DCMs, DCOs, FCMs, CPOs, Large Traders, ECPs, and ESPs
      2. SDs, MSPs, SEFs, and SDRs
      3. Entities Eligible To Engage in Options on Physical Commodities on DCMs Under Part 33
      4. Entities Engaged in Options Under § 32.13(g)
      5. Entities Engaged in Options Under existing § 32.4
    - C. *Paperwork Reduction Act*
  - VIII. Final Rule and Interim Final Rule

#### I. Introduction

##### A. *Dodd-Frank Act*

On July 21, 2010, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act

<sup>1</sup> 17 CFR 145.9.

(“Dodd-Frank Act”).<sup>2</sup> Title VII of the Dodd-Frank Act<sup>3</sup> amended the Commodity Exchange Act (“CEA” or “Act”)<sup>4</sup> to establish a comprehensive new regulatory framework for swaps and security-based swaps. The legislation was enacted to reduce risk, increase transparency, and promote market integrity within the financial system by, among other things: (1) Providing for the registration and comprehensive regulation of swap dealers (“SDs”) and major swap participants (“MSPs”); (2) imposing clearing and trade execution requirements on standardized derivative products; (3) creating robust recordkeeping and real-time reporting regimes; and (4) enhancing the Commission’s rulemaking and enforcement authorities with respect to, among others, all registered entities and intermediaries subject to the Commission’s oversight.

#### *B. Notice of Proposed Rulemaking—February 3, 2011; Final Rule and Interim Final Rule*

Section 721 of the Dodd-Frank Act added new section 1a(47) to the CEA, defining “swap” to include not only “any agreement, contract, or transaction commonly known as,” among other things, “a commodity swap,”<sup>5</sup> but also “[an] option of any kind that is for the purchase or sale, or based on the value, of 1 or more \* \* \* commodities \* \* \*.”<sup>6</sup> As a result of the Dodd-Frank

changes, on February 3, 2011, the Commission published in the **Federal Register** a notice of proposed rulemaking (“NPRM”) that included proposed regulations for commodity options.<sup>7</sup> This final rule and interim final rule relates to the commodity options proposal in the NPRM. In particular, the final rule issued herein adopts the Commission’s proposal to generally permit market participants to trade commodity options, which are statutorily defined as swaps,<sup>8</sup> subject to the same rules applicable to every other swap. The interim final rule adopted herein includes a trade option exemption for physically delivered commodity options purchased by commercial users of the commodities underlying the options, subject to certain conditions. This final rule and interim final rule also renumbers the commodity options rules, as compared to the proposal in the NPRM, and deletes a provision from the proposed rules that the Commission has determined is no longer relevant.

As noted above, because the Dodd-Frank Act definition of swap includes commodity options, the NPRM proposed provisions that would substantially amend the Commission’s regulations regarding such commodity option transactions. The proposed rules for commodity options, including proposed amendments to parts 3, 32, and 33, generally included provisions that would have subjected all commodity options that are swaps to the same rules applicable to any other swap. After thoroughly reviewing the

comments submitted in response to the NPRM, the Commission has determined to issue the commodity options rules proposed in the NPRM as final rules, with certain non-substantive amendments, including the deletion of a “prompt execution” requirement and other requirements that are no longer relevant, as well as minor formatting updates (e.g., renumbering). In addition, and in response to the commenters, this final rulemaking also includes an interim final rule relating to trade options, as discussed in detail below.

## **II. Commodity Options Background**

### *A. Commission’s Plenary Statutory Authority Over Commodity Options*

The CEA provides:

No person shall offer to enter into, enter into or confirm the execution of, any transaction involving any commodity regulated under this chapter which is of the character of, or is commonly known to the trade as, an “option”, “privilege”, “indemnity”, “bid”, “offer”, “put”, “call”, “advance guaranty”, or “decline guaranty”, contrary to any rule, regulation, or order of the Commission prohibiting any such transaction or allowing any such transaction under such terms and conditions as the Commission shall prescribe. Any such order, rule, or regulation may be made only after notice and opportunity for hearing, and the Commission may set different terms and conditions for different markets.<sup>9</sup>

Through this provision, Congress has given the Commission jurisdiction and plenary rulemaking authority over all commodity option transactions. Notably, while the Dodd-Frank Act included numerous amendments to the CEA, the plenary options authority provision in CEA section 4c(b) was not amended or otherwise altered by the Dodd-Frank Act. Rather, CEA section 4c(b) has been in the Act in substantially the same form since it was added by the Commodity Futures Trading Commission Act of 1974.<sup>10</sup> The Commission has primarily used its options authority to promulgate the commodity options rules in parts 32 (Regulation of Commodity Option Transactions)<sup>11</sup> and 33 (Regulation of Domestic Exchange-Traded Commodity Option Transactions)<sup>12</sup> of the existing regulations, as well as to support the adoption of the swaps rules in part 35.<sup>13</sup>

<sup>2</sup> See Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111–203, 124 Stat. 1376 (2010). The text of the Dodd-Frank Act may be accessed at <http://www.cftc.gov/LawRegulation/OTCDERIVATIVES/index.htm>.

<sup>3</sup> Pursuant to section 701 of the Dodd-Frank Act, Title VII may be cited as the “Wall Street Transparency and Accountability Act of 2010.”

<sup>4</sup> 7 U.S.C. 1 *et seq.*

<sup>5</sup> 7 U.S.C. 1a(47)(A)(iii)(XXII).

<sup>6</sup> See 7 U.S.C. 1a(47)(A)(i). Note that the swap definition excludes options on futures (which must be traded on a DCM pursuant to part 33 of the Commission’s regulations) (see CEA section 1a(47)(B)(i), 7 U.S.C. 1a(47)(B)(i)), but it includes options on physical commodities (whether or not traded on a DCM) (see CEA section 1a(47)(A)(i), 7 U.S.C. 1a(47)(A)(i)). Other options excluded from the statutory definition of swap are options on any security, certificate of deposit, or group or index of securities, including any interest therein or based on the value thereof, that is subject to the Securities Act of 1933 and the Securities Exchange Act of 1934 (see CEA section 1a(47)(B)(iii), 7 U.S.C. 1a(47)(B)(iii)) and foreign currency options entered into on a national securities exchange registered pursuant to section 6(a) of the Securities Exchange Act of 1934 (see CEA section 1a(47)(B)(iv), 7 U.S.C. 1a(47)(B)(iv)). Note also that the Commission’s regulations define a commodity option transaction or commodity option as “any transaction or agreement in interstate commerce which is or is held out to be of the character of, or is commonly known to the trade as, an ‘option,’ ‘privilege,’ ‘indemnity,’ ‘bid,’ ‘offer,’ ‘call,’ ‘put,’ ‘advance guaranty’ or ‘decline guaranty.’” 17 CFR 1.3(hh).

For purposes of this release, the Commission uses the term “commodity options” to apply solely to commodity options not excluded from the swap definition set forth in CEA section 1a(47)(A), 7 U.S.C. 1a(47)(A). As will be discussed in greater detail below, the Commission is undertaking a definitions rulemaking in conjunction with the Securities and Exchange Commission (“SEC”) to further define, among other things, the term “swap.” See Further Definition of “Swap,” “Security-Based Swap,” and “Security-Based Swap Agreement”; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, 76 FR 29818, May 23, 2011 (“Product Definitions NPRM”). The final rule and interpretations that result from the Product Definitions NPRM will address the determination of whether a commodity option or a transaction with optionality is subject to the swap definition in the first instance. If a commodity option or a transaction with optionality is excluded from the scope of the swap definition, as further defined by the Commission and the SEC, the final rule and/or interim final rule adopted herein are not applicable.

<sup>7</sup> Commodity Options and Agricultural Swaps, 76 FR 6095, Feb. 3, 2011. Note that in addition to proposed commodity options rules, the NPRM also included proposed rules for agricultural swaps. The agricultural swaps rules were adopted by the Commission via a final rulemaking published on August 10, 2011 and are not addressed herein. See Agricultural Swaps, 76 FR 49291, Aug. 10, 2011 (“Final Agricultural Swaps Rules”).

<sup>8</sup> See note 6, above.

<sup>9</sup> See CEA section 4c(b), 7 U.S.C. 6c(b).

<sup>10</sup> Public Law 93–463, October 23, 1974.

<sup>11</sup> 17 CFR part 32.

<sup>12</sup> 17 CFR part 33.

<sup>13</sup> 17 CFR part 35. CEA section 4c(b) was cited as one of the authorizing statutory provisions for original part 35, entitled “Exemption of Swap Agreements.” See Exemption of Swap Agreements, 58 FR 5587, at 5589, Jan. 22, 1993 (noting that: “In enacting this exemptive rule, the Commission is

### *B. The NPRM Proposed an Overhaul of Existing Commodity Options Regulations*

As explained in the introduction, the Dodd-Frank Act includes a definition of swap that encompasses commodity options.<sup>14</sup> The Commission proposed the commodity options rules in the NPRM to address the fact that the existing rules applicable to commodity options<sup>15</sup> pre-date the Dodd-Frank Act provisions applicable to all other swaps and, therefore, do not consider or incorporate such provisions.<sup>16</sup> Therefore, the rules in the NPRM would have amended part 32 to essentially permit commodity options to trade subject to the same rules applicable to any other swap. The NPRM contains a detailed description of the historical development of part 32 and the proposed changes.<sup>17</sup> The NPRM also includes proposed updates to part 33, which currently applies to any option traded on a designated contract market ("DCM") (whether an option on a future or an option on a physical). In order to place all options that are swaps under a single part of title 17 of the Code of Federal Regulations ("CFR"),<sup>18</sup> the NPRM proposed to remove from part 33 any reference to an "option on a physical,"<sup>19</sup> leaving part 33 applicable only to exchange-traded options on futures, and allowing part 32 to serve as the sole relevant regulation for all other commodity options (including both exchange-traded options on physical commodities and all off-exchange

also acting under its plenary authority under section 4c(b) of the Act with respect to swap agreements that may be regarded as commodity options." In addition, when the Commission recently repealed original part 35 and replaced it with new part 35, entitled "Agricultural Swaps," CEA section 4c(b) was again cited as one of the authorizing statutory provisions. See Final Agricultural Swaps Rules, 76 FR at 49295–49296, n.36, Aug. 10, 2011 ("The Commission is clarifying now that the new part 35, which will apply only to swaps in agricultural commodities, is similarly adopted pursuant to the authorities found in CEA sections 4(c) and 4c(b).").

<sup>14</sup> See note 6, above.

<sup>15</sup> Those existing rules encompassed primarily parts 32 and 33, but also original part 35, which was a general swap exemption applicable to, among other things, commodity options that did not qualify for the trade option exemption.

<sup>16</sup> In some cases, the pre Dodd-Frank commodity options rules are inconsistent with certain Dodd-Frank Act provisions, such as the lack of a requirement in pre Dodd-Frank § 32.4 (17 CFR 32.4) that counterparties to trade options be eligible contract participants ("ECPs"). In contrast, section 2(e) of the CEA, 7 U.S.C. 2(e), as amended by the Dodd-Frank Act, requires that counterparties to all swaps not conducted on or subject to the rules of a designated contract market be ECPs.

<sup>17</sup> See NPRM, 76 FR 6095, at 6097–6098; 6101–6103, Feb. 3, 2011.

<sup>18</sup> The Commission's regulations are set forth in title 17 of the CFR.

<sup>19</sup> See NPRM, 76 FR at 6103, Feb. 3, 2011.

commodity options). In addition, the NPRM proposed repealing the swap exemption in original part 35 and replacing it with rules for agricultural swaps pursuant to Dodd-Frank's mandate that agricultural swaps only be permitted pursuant to rules set by the Commission.<sup>20</sup>

Under the NPRM, proposed new part 32 would have governed all commodity options that fall under the Dodd-Frank swap definition<sup>21</sup> by permitting such commodity options to be transacted subject to the same laws and rules applicable to any other swap—without distinguishing between trade options and non-trade options. An additional element of new part 32, as proposed in the NPRM, was the elimination of the historical distinction between the treatment of options on the enumerated agricultural commodities and options on all other commodities. As proposed in the NPRM, new part 32 would treat options on both enumerated and non-enumerated agricultural commodities the same as all other commodity options. Finally, the NPRM included, at proposed § 32.5, a grandfather clause providing that "[n]othing contained in this part shall be construed to affect any lawful activities prior to the effective date of this part." That grandfather provision is retained unaltered in this final rule.

### **III. Comments on the Commodity Options Proposal in the NPRM**

#### *A. Request for Comment on the NPRM*

In the NPRM, the Commission requested specific input on the following questions related to the commodity options proposal:

- Generally, will the rule changes and amendments proposed herein provide an appropriate regulatory framework for the transacting of trade options on all commodities?

- Regarding the proposed revisions to part 32, and specifically the revised § 32.4 trade option exemption, will such revisions significantly affect hedging opportunities available to currently active users of the trade options market? In other words, is there any reason not to revise § 32.4 as proposed? In particular, are there persons who offer or purchase trade options on non-enumerated agricultural commodities (e.g., coffee, sugar, cocoa) under current § 32.4 who would not qualify as ECPs and would therefore be ineligible to

<sup>20</sup> See section 723(c)(3) of the Dodd-Frank Act. As explained in note 7, above, the proposals in the NPRM related to part 35 and agricultural swaps have already been adopted by the Commission as final rules.

<sup>21</sup> See note 6, above.

participate in such options under revised § 32.4? If so, should such participants be excepted from the general requirement that all swaps participants must be ECPs unless the transaction takes place on a DCM?

- Regarding the proposed withdrawal of § 32.12 (the dealer option provision) in its entirety, would such action (in conjunction with the adoption of the new rules proposed herein) prejudice or otherwise harm any person, group of persons, or class of transactions? In other words, is there any reason not to withdraw § 32.12 as proposed?

- Similarly, and regarding the proposed withdrawal of § 32.13 (the agricultural trade option provision) in its entirety, would such action (in conjunction with the adoption of the new rules proposed herein) prejudice or otherwise harm any person, group of persons, or class of transactions? In other words, is there any reason not to withdraw § 32.13 as proposed?

- Do the proposals as they relate to part 33 appropriately limit the scope of part 33 to DCM-traded options on futures, leaving DCM-traded options on physical commodities subject to part 32?

- Do the proposals outlined herein omit or fail to appropriately consider any other areas of concern regarding options in any commodity?

#### *B. Summary of Comments on the NPRM*

##### *1. General Overview*

Approximately 39 comment letters were submitted that substantively addressed the NPRM,<sup>22</sup> representing a

<sup>22</sup> The public comment file for the NPRM is available at: <http://comments.cftc.gov/PublicComments/CommentList.aspx?id=968>. This comment summary references each of the comments that substantively addressed the commodity options proposal in the NPRM, whether submitted in response to the original NPRM, in response to the Commission's general reopening of the comment period for multiple Dodd-Frank rule proposals (See Reopening and Extension of Comment Periods for Rulemakings Implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 FR 25274, May 4, 2011 ("Dodd-Frank General Reopening")), or in response to the joint CFTC and SEC Product Definitions NPRM. Note that none of the comments submitted in response to Dodd-Frank General Reopening specifically addressed the commodity options proposal in the NPRM, and so they are not discussed in detail herein. In addition, certain comments submitted on this rulemaking may also be addressed by the final rule implementing the proposals in the Product Definitions NPRM. Finally, the public comment file for the NPRM also includes multiple comments that did not directly address the commodity options proposal (for example, see the comments from Majed El Zein, B.J. D'Milli, Maryknoll Office for Global Concerns, Maryknoll Fathers and Brothers, J.C. Hoyt, and Jon Pike), other comments that only addressed the proposed agricultural swaps rules, and four records of meetings or communications between Commission staff and interested industry groups.

broad range of interests, including agricultural producers, merchants, SDs, commodity funds, futures industry organizations, academics and think tanks, a U.S. government agency, and private individuals. Twenty-one different commenters, through various letters, specifically addressed the commodity options proposal. Commodity options comments on the NPRM were filed by entities including: The Financial Services Roundtable ("FSR"); CME Group, Inc. ("CME Group" or "CME"); Futures Industry Association and International Swaps and Derivatives Association ("FIA & ISDA"); Edison Electric Institute and Electric Power Supply Association ("EIA-EPISA"); National Grain and Feed Association ("NGFA"); staff of the Federal Energy Regulatory Commission ("FERC Staff"); American Public Gas Association ("APGA"); Air Transport Association of America ("ATA"); Amcort; Coalition of Physical Energy Companies ("COPE"); Gavilon Group, LLC ("Gavilon"), which submitted two letters; a joint letter from National Rural Electric Cooperative Association, American Public Power Association, and Large Public Power Council (together, the "Power Coalition"); Working Group of Commercial Energy Firms ("Energy Working Group"); Commodity Markets Council ("CMC"); Hess Corporation ("Hess"); a commodity options and agricultural swaps working group that includes Barclays Capital, Citigroup, Credit Suisse Securities (USA) LLC, JPMorgan Chase & Co., Morgan Stanley, and Wells Fargo & Company (together, "Commodity Options and Agricultural Swaps Working Group"); and American Gas Association ("AGA"). Commodity options comments filed on the Product Definitions NPRM included a joint letter from Natural Gas Supply Association and National Corn Growers Association ("NGSA & NCGA"); a second letter from COPE; a letter from Just Energy Group ("Just Energy"); a letter from American Petroleum Institute ("API"); a second letter from the Energy Working Group; a letter from BG Americas & Global LNG ("BGA"); and a second letter from the Power Coalition.

## 2. Comments on the Commodity Options Proposal

The commodity options comments generally focused on the following substantive areas as they related to the commodity options proposal in the NPRM.

### a. Whether the Definition of Swap Includes Commodity Options

Multiple commenters expressed the opinion that treating options as swaps, as set forth in the NPRM, was premature and should await the Commission's joint rulemaking with the SEC on the further definition of a swap.<sup>23</sup> In particular, FIA-ISDA expressed the opinion that the definitions rulemaking "is the proper place to address whether physical commodity options of any kind, including agricultural commodity options, should be treated as swaps" and thus urged the Commission to defer the commodity options rulemaking until such time as it issues a final rulemaking further defining a swap. *See* FIA & ISDA at 4. Similar sentiments were expressed by NextEra, EIA-EPISA, the Power Coalition, and the Energy Working Group. For example:

As a threshold matter, the Proposed Rule is premature insofar as it would treat options on physical commodities as swaps before the Commission has even proposed the definition of what constitutes a swap pursuant to Section 712(d) of the Dodd-Frank Act. \* \* \* To avoid inconsistent outcomes and ensure consideration of an integrated and complete record on transactions to be regulated as swaps, the Commission should stay this proceeding insofar as it would define commodity options as swaps.

EIA-EPISA at 1–2.

[T]he Working Group respectfully requests that the Commission stay the instant proceeding until such time that the mandatory final rule further defining the term 'swap' set forth in new Section 1a(47) of the [CEA] is jointly issued by the Commission and the [SEC]. Until the full scope and application of the definition of 'swap' is known and understood, the Working Group is unable to fully evaluate the potential implications of the Proposed Rule, or comment meaningfully on how the proposed regulation of Physical Options could ultimately affect its members.

Energy Working Group at 2.

Beyond the requests to delay the commodity options final rulemaking, some commenters disagreed with the interpretation that the Dodd-Frank swap definition was intended to include all commodity options. The following comments illustrate this view:

Simply put, a commodity option is not a swap \* \* \* COPE requests that the Commission find that, unlike swap options, commodity options are not swaps.

COPE at 4–5.

The text and structure of the Dodd-Frank Act indicates that Congress only intended to include options that require financial settlement and other financial products in the definition of 'swap.'

Gavilon 4/4/11 letter at 4.

Physical Options meet the criteria of the so-called 'forward contract exclusion' under section 1a(47)(B)(ii) of the CEA and therefore must be excluded from the definition of a 'swap' under section 1a(47).

NGSA & NCGA letter at 3.<sup>24</sup> *See also*, letters from AGA and API.

The Energy Working Group acknowledged that the swap definition likely included options, but argued that the Commission should take action to avoid that result:

Although Congress included Physical Options in the definition of 'swap,' it also vested the Commission with the statutory authority [referencing CEA section 4c(b)] to regulate options, including Physical Options, in a manner different than swaps. The Working Group's members consider Physical Options as distinct from other 'swaps,' and more akin to physically-settled forward contracts, and believe that there are substantive policy reasons to treat these types of transactions in a similar manner. Regulating Physical Options as swaps under Title VII of the Act would have a substantial negative effect on not only the market for such options, but also more broadly on physical energy markets and participants in such markets that rely on physical energy commodities during their normal course of business.

Energy Working Group at 4.

The Energy Working Group letter went on to provide several examples of "transactions that energy market participants do not historically consider options, but nonetheless contain an element of optionality \* \* \* and should not be regulated as swaps." Their letter described contracts called daily natural gas calls, wholesale full requirements contracts for power, tolling agreements in organized wholesale electricity markets, physical daily heat rate call options, and capacity contracts. *See* Energy Working Group at Exhibit A. APGA and ATA also requested that the Commission clarify that certain variable amount delivery contracts that are common in the energy sector be excluded from the definition of a swap. CMC requested that the Commission clarify that certain other types of transactions fall within the definition of an excluded forward contract rather than the definition of a swap. CMC specifically commented that cash

<sup>23</sup> *See* Product Definitions NPRM, 76 FR 29818, May 23, 2011. The Commission notes that, where applicable, the definitions-based comments are also being considered in conjunction with its effort, jointly with the SEC, to further define certain products, including the term "swap," pursuant to § 712(d) of the Dodd-Frank Act.

<sup>24</sup> As discussed below, the NGSA & NCGA letter supported, in the alternative, multiple different approaches to their end goal of exempting or excluding physically settled commodity options from swap regulation.

forward contracts with embedded options and certain cash transaction book-outs should not be treated as “swaps.” CMC at 1. Amcot requested clarification that “equity trades” or “options to redeem” cotton from the U.S. Department of Agriculture’s Commodity Credit Corporation marketing loan program would not be considered swaps.<sup>25</sup>

Regarding those comments describing specific transactions, and in particular CMC’s comments, the Commission notes that the proposed further definition of swap included a discussion of the applicability of the swap definition to both forwards with embedded options and book-out transactions.<sup>26</sup> The Commission further notes that, in response to both the NPRM and the Product Definitions NPRM, several comments were submitted regarding “volumetric options” in particular (*i.e.*, optionality in a contract settling by physical delivery that is used to meet varying demand for a commodity). The final further definition of the term swap to be issued by the Commission and the SEC will address the applicability of the swap definition (and thus, the applicability of this final rule and interim final rule) to such volumetric options.<sup>27</sup>

#### b. Trade Option Exemption

While the commodity options rules proposed in the NPRM would have removed the trade option exemption that is currently at 17 CFR 32.4,<sup>28</sup> the vast majority of commenters who expressed an opinion on the topic

<sup>25</sup> After CFTC staff reviewed the “options to redeem” with both USDA staff members responsible for managing the cotton marketing loan program and industry representatives from Amcot (an association of US cotton marketing cooperatives), the Commission has concluded that the “options to redeem” under USDA’s cotton marketing loan program constitute the producer’s contractual right to repay the marketing loan and “redeem” the collateral (the cotton), to sell in the open market. As such, the “option” to redeem cotton under USDA Commodity Credit Corporation’s marketing loan program is a standard loan repayment term and does not constitute a commodity option within the meaning of the CEA and CFTC regulations.

<sup>26</sup> See Product Definition NPRM, 76 FR at 29827–29830, May 23, 2011.

<sup>27</sup> See note 6, above.

<sup>28</sup> Current 17 CFR 32.4(a) provides: “\* \* \* the [prohibition on off-exchange commodity options contained in 17 CFR 32.11] shall not apply to a commodity option offered by a person which has a reasonable basis to believe that 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 by-products thereof, and that 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.”

supported retaining a trade option exemption, in one form or another, for options that require physical delivery if exercised, and were opposed to treating such options as swaps subject to all applicable Dodd-Frank swaps regulatory requirements. The current trade option exemption is an exemption from the existing prohibition against off-exchange commodity option transactions in 17 CFR 32.11. In contrast, the commenters requested a trade option exemption for the purpose of being exempt from (1) the swap definition, and/or (2) any final rules that would treat commodity options the same as any other swap. The following statement from Hess Corporation illustrates this view that certain options should not be regulated as swaps:

Treating all options, financial and physical, as swaps will result in significant unintended consequences for Hess and other commercial entities that rely on physical options to manage their business risk. Hess does not believe Congress intended such a result. On the contrary, Hess believes that the Dodd-Frank Act defines ‘swap’ in a manner that plainly distinguishes between financial and physical transactions. Accordingly, Hess urges the Commission to regulate options in a similar manner by excluding options that are intended to be physically settled once exercised from the definition of ‘swap.’

Hess Corporation at 1. Similar sentiments were expressed by the Power Coalition, the Energy Working Group, Gavilon, APGA, ATA, NCSA & NCSA, AGA, API, and COPE. For example:

If the Commission proposes rules to discard the ‘trade option exemption,’ it should concurrently replace it with a ‘trade option exemption for nonfinancial commodities’ to the defined term ‘swap.’

Power Coalition at 15.

Gavilon urges the Commission to issue an order pursuant to CEA Section 4c(b) that allows commercial entities to enter into Physical Options subject only to conditions that are comparable to the requirements in current Part 32.4.

Gavilon April 4, 2011 letter at 6–7.

[R]egulation of Physical Options as ‘swaps’ would cause serious harm to the natural gas and other physical commodity markets, without providing significant benefits \* \* \*. For these reasons, the Commission must recognize, in its final rule, either in the definition of a ‘swap’ or by preserving the trade option exemption, that Physical Options are excluded, or are eligible for exemption, from regulation as swaps.

NGSA & NCSA at 4–5.

[I]f the Commission determines to move forward with the [Options NPRM], it must make clear that no physically settled agreements are covered [or] included in any rule pertaining to swaps.

COPE at 5. CME expressed the opinion that “[We believe that] Congress did not necessarily intend for the Commission to treat all options on commodities as ‘swaps’ \* \* \* but we have no objection to this outcome.” CME at 3.

#### c. Eligible Contract Participants and Trade Options

The energy industry commenters expressed concerns regarding the fact that treating commodity options as swaps would require all trade options counterparties to be ECPs—because trade options are typically bilateral, off-exchange transactions, and CEA section 2(e) permits only ECPs to transact swaps other than on or subject to the rules of a DCM. The commenters noted that there are many non-ECP market participants who currently rely on the trade option exemption for option transactions in a wide range of commodities. For example:

If the Commission eliminates the ability of the NFP Electric End Users to engage in energy and energy-related commodity options, or conditions the use of such trade options on the NFP Electric End Users qualifying as eligible contract participants, it will have a significant and detrimental effect on the NFP Electric End Users’ ability to hedge their commercial risk in a cost effective way.

Power Coalition at 14.

The Commodity Options NOPR states that, ‘based on its review [of the history of the Commission’s development of commodity options regulation], the Commission has determined that there would be little practical effect and no detrimental consequences in adopting the proposed revisions to the existing commodity options regime in part 32.’ [citing NPRM at 76 FR 6101]. The Coalition disagrees strongly with the Commission’s determination \* \* \*. We consider the Commission’s Proposed Rule to be highly detrimental to the NFP Electric End Users’ ability to provide affordable electric energy to American businesses and consumers.

Power Coalition at 16.

Since, in general, market participants must meet certain net worth thresholds to qualify as an ‘eligible contract participant’ [footnote omitted] and many Physical Options used by small end users are customized or illiquid and thus not traded on exchanges, the ability of small end users to transact in Physical Options would be limited to on-exchange contracts that do not exist or do not match their needs.

NGSA & NCSA at 4.

Similarly, the FSR pointed out, in a comment primarily addressing the proposed definition of ECP,<sup>29</sup> that there

<sup>29</sup> See: Further Definition of “Swap Dealer,” “Security-Based Swap Dealer,” “Major Swap Participant,” “Major Security-Based Swap

may be issues with the fact that the proposal in the NPRM to modify the trade option exemption would eliminate the availability of the trade option exemption for non-ECPs. *See* FSR at 26, n.18.

#### d. FERC-Regulated Transactions

FERC Staff noted that “depending on how broadly the term ‘swap’ is construed, CFTC regulation of swaps could lead to inconsistent regulation of participants and transactions subject to FERC jurisdiction, and in particular the organized electricity markets.” FERC Staff at 1. The energy and electricity commenters also expressed concerns about the jurisdictional overlap. One commenter specifically noted that, “[Physical Options] in the natural gas market are already subject to certain regulatory oversight by [FERC] and state public utility commissions with respect to price, prudence, and manipulation.” NGA & NCGA at 5.

#### e. Deleting the Dealer Option Provisions

FIA-ISDA supported the proposed withdrawal of regulation 32.12 (pertaining to the grandfathering of certain dealer options). In particular, FIA-ISDA concurred with the Commission’s assertion that “the dealer option business has not existed since the early 1990s” and thus there is no longer a need for this grandfathering provision. *See* FIA-ISDA at 6.

#### f. Deleting the Agricultural Trade Option Provisions

There was only one comment related to eliminating the Agricultural Trade Option (ATO) Merchant provisions in part 32. Specifically, NGFA supported eliminating the provisions, observing:

[NGFA] long has believed that an effective ATO regulatory structure could benefit agricultural producers and the agribusinesses with which they work to develop marketing strategies and market their crops. However, the rules in place have been unwieldy and, consequently, the ATO merchant registration regime has been largely unused \* \* \*. The NGFA believes the redefinition of ATOs as swaps, subject to conditions under Dodd-Frank (notably the Eligible Contract Participant rules), will result in enhanced development and use of products that formerly would have been categorized as agricultural trade options and a broader range of risk management tools.

NGFA at 2.

Participant” and “Eligible Contract Participant,” 75 FR 80174, Dec. 21, 2010 (joint rulemaking with SEC; the comment period originally closed on February 22, 2011, and was extended to June 3, 2011).

#### g. Options Fraud Provisions

The proposed rules for commodity options in the NPRM would have retained the existing enforcement provisions in part 32, *i.e.*, § 32.8 (“Unlawful representations; execution of orders”) and § 32.9 (“Fraud in connection with commodity option transactions”). EEI-EPSC requested a modification of § 32.9, regarding fraud in connection with commodity option transactions, to include a “requisite intent” requirement. EEI-EPSC at 11.

As noted above, in the final rule issued herein, the Commission is retaining § 32.9 (“Fraud in connection with commodity option transactions”), which has been renumbered as § 32.4, but not otherwise changed. The Commission is not including the requisite intent standard requested by EEI-EPSC, because it would narrow the scienter standard for fraud established by Commission precedent, which is “intentionally or with reckless disregard.”<sup>30</sup> Moreover, in first promulgating its option fraud regulation, the Commission did “not use the concept of willful behavior” in the regulation text out of concern regarding the potential for courts to take a restrictive view of the Commission’s antifraud authority.<sup>31</sup> The final rule does not retain § 32.8 (“Unlawful representations; execution of orders”). That provision was originally intended to apply to the retail over-the-counter (“OTC”) options market. Such retail OTC options transactions have been prohibited since the adoption of the general options prohibition at § 32.11 in 1978.<sup>32</sup> Thus § 32.8 is no longer necessary, particularly since the violations listed in § 32.8 are either irrelevant (in that they apply to intermediated transactions, whereas trade options are generally principal-to-

principal transactions) or are subsumed by the general antifraud rule, or both.

### IV. Explanation of the Final Rule and Interim Final Rule for Commodity Options

#### A. Introduction

After considering the complete record in this matter, including all comments to the NPRM, the Commission is now adopting and issuing this final rule and interim final rule for commodity options. Broadly speaking, the final rule would implement the commodity option rules as proposed in the NPRM, whereby commodity options are permitted subject to the same rules as all other swaps, with additional minor revisions to part 32. In addition, the interim final rule includes a new trade option exemption from certain swaps regulations.

#### B. Sections Unchanged From the NPRM

The final rule as it relates to revisions to part 3 and to part 33 of the Commission’s regulations is the same as in the NPRM.<sup>33</sup>

#### C. New Part 32

##### 1. Final Rule

The Commission is publishing this final rule in order to provide increased regulatory certainty to market participants transacting commodity options, along with an interim final rule to permit additional public comment on a new trade option exemption. The final rule issued herein generally adopts the commodity options proposal as set forth in the NPRM. That is, under this final rule, commodity options will be permitted to transact subject to the same rules applicable to any other swap. This general authorization is necessary because the Commission’s plenary rulemaking authority over commodity options provides that: “[n]o person shall offer to enter into, enter into or confirm the execution of, any transaction involving any commodity regulated under this chapter which is [a commodity option transaction], contrary to any rule, regulation, or order of the Commission prohibiting any such transaction or allowing any such transaction under such terms and conditions as the Commission shall prescribe.”<sup>34</sup> By adopting this final rule, the Commission provides the required general authorization for commodity options that are subject to the swap

<sup>30</sup> *See In re Osler*, CFTC Docket No. 00–5, 2001 WL 138975 (CFTC Feb. 15, 2001) (finding options fraud in violation of regulations 32.9 and 33.10; “A person acts with scienter if he acts intentionally, or with reckless disregard for his duties under the Act.” (citing *Hammond v. Smith Barney Harris Upham & Co.*, [1987–1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,617 at 36,659 (CFTC March 1, 1990)).

<sup>31</sup> *See Part 30—Fraud in Connection with Commodity Transactions*, 40 FR 26504, at 26505 and note 2, June 24, 1975 (adopting final rules in connection with commodity options and certain other transactions; “by adopting rules patterned by antifraud provisions that Congress has approved as part of the statutory scheme of the Commodity Exchange Act [in section 4b], the Commission can fairly expect that the courts will adopt a consistent and uniform approach to the prevention of fraudulent and deceptive acts and practices under the Commodity Exchange Act”).

<sup>32</sup> *See Suspension of the Offer and Sale of Commodity Options*, 43 FR 16153, Apr. 17, 1978.

<sup>33</sup> For the purposes of part 33, as amended herein, the Commission clarifies that an option on a futures contract is an option that, upon exercise, results in a futures position.

<sup>34</sup> *See* CEA section 4c(b).

definition,<sup>35</sup> and removes any uncertainty as to whether CEA section 4c(b) would otherwise prohibit such commodity options.

The remainder of the final rule (*i.e.*, everything else in new part 32) largely tracks the commodity options language proposed in the NPRM, with a few minor revisions, including formatting and renumbering changes. For example, the final rule renumbers the sections of new part 32 to delete (rather than reserve, as had been proposed in the NPRM) the provisions in existing part 32 that are being deleted. A second difference is that the proposal in the NRPM would have retained existing § 32.8, entitled “Unlawful representations; execution of orders,” while this final rule deletes that provision, as discussed above. Moreover, this commodity options final rule retains the strong options antifraud language that was proposed in the NPRM at § 32.9 (now renumbered as § 32.4).<sup>36</sup> In addition, the general commodity options authorization, proposed as § 32.4 and renumbered herein as § 32.2, has been reformatted and updated to include a reference to the interim final rule, *i.e.*, the new § 32.3 trade option exemption, which is described in detail, below.

## 2. Interim Final Rule; Trade Option Exemption

### a. Exemption From General Swaps Rules

The interim final rule incorporates a new § 32.3 into part 32, providing an exemption from certain swaps regulations for trade options on exempt and agricultural commodities as between certain commercial and sophisticated counterparties. This trade option exemption will operate as an alternative to the general commodity options authorization in § 32.2. Pursuant to the trade option exemption issued as an interim final rule herein, if the offeror,<sup>37</sup> the offeree,<sup>38</sup> and the characteristics of the option transaction meet the requirements of the trade option exemption, such option transaction will be exempt from the general Dodd-Frank swaps regime,<sup>39</sup>

subject to specified ongoing conditions and compliance requirements discussed below, as applicable.

### b. Offeror

Under the terms of the interim final rule, the offeror must fall into one of two categories. The offeror may be an ECP, which assures that option grantors will have some minimal level of financial resources and sophistication in order to minimize the risk that a seller would not be able to perform its obligations under a commodity option.<sup>40</sup> Alternatively, the offeror may be 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 by-products thereof, and be offering or entering into the transaction solely for purposes related to its business as such. Because the trade option exemption generally is intended to permit parties to hedge or otherwise enter into transactions for commercial purposes, and because certain commercial parties prefer to transact primarily with other commercial parties, the trade option exemption set forth in the interim final rule specifically authorizes commercials who may not be ECPs to act as trade option offerors. In either instance, the trade option offeror may only offer or enter into the contract if it reasonably believes, consistent with the standard in the existing trade option exemption, that the offeree meets the offeree requirements specified below.

### c. Offeree

The offeree must meet the same basic requirements as under the existing trade option exemption. That is, the option buyer must be 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 by-products thereof, and be entering into the transaction solely for purposes related to its business as such. Note that there is no ECP requirement or other financial eligibility standard for the offeree. The purpose of requiring the trade option buyer to be a commercial, and of not imposing an ECP or other financial eligibility standard, is to ensure that hedging opportunities for

commercial entities, for physically delivered transactions used for purposes related to their business as such, remain available regardless of the size or sophistication of the commercial entity.

### d. Physical Commodity Option

The third element of the trade option exemption is that both parties must intend that the commodity option be physically settled, so that, if exercised, the option would result in the sale of an exempt or agricultural (*i.e.*, non-financial) commodity for immediate (spot)<sup>41</sup> or deferred (forward) shipment or delivery. To assist parties in determining whether the sale of the exempt or agricultural commodity is intended to be physically settled, the Commission refers parties to the forward contract exclusion guidance as provided in the Product Definition NPRM,<sup>42</sup> or such other guidance as ultimately may be adopted in the final product definition rulemaking. That is, to the extent the obligations that remain (or are created) upon the exercise of a commodity option are spot transactions or fall within the forward contract exclusion from the swap definition, such commodity option is eligible for the trade option exemption.

### e. Trade Option Exemption Conditions

While the trade option exemption issued herein would operate as a general exemption from the rules otherwise applicable to other swaps (*i.e.*, the Dodd-Frank swaps regime), the trade option exemption is subject to certain

<sup>41</sup> If not specified by law (*see, e.g.*, CEA section 2(c)(2)(C)(i)(II)(bb)(AA), 7 U.S.C. 2(c)(2)(C)(i)(II)(bb)(AA)) or cash market practice, to be a spot transaction, rather than a forward transaction, delivery must occur “within a reasonable time [after the contract is executed] in accordance with prevailing cash market practice.” Regulation of Noncompetitive Transactions Executed on or Subject to the Rules of a Contract Market, 63 FR 3708, 3711, Jan. 26, 1998 (concept release). Delivery under a spot contract usually occurs within a few days of the trade date. *See* CFTC Interpretative Letter 98–73, available at <http://www.cftc.gov/ucm/groups/public/@lrllettergeneral/documents/letter/98-73.pdf> (October 1998), stating that “[i]n a spot transaction, immediate delivery of the product and immediate payment for the products are expected on or within a few days of the trade date” and citing CFTC Interpretative Letter No. 97–01, 1996–98 Transfer Binder Comm. Fut. L. Rep. (CCH) ¶ 26,937 at p. 44,520 (December 12, 1996), in turn citing Timothy J. Snider, Regulation of the Commodities Futures and Options Markets, Vol. 1, § 9.01 (2ed. 1995). However, under cash market practices in some markets, delivery can occur more than a few days after the trade date. *See* CFTC, Division of Trade and Markets: Report on Exchange of Futures for Physicals 51, 65, 124–147 (1987) (noting that under then-prevailing cash market practices, transactions in crude oil and sugar called for delivery in 30 and 75 days, respectively, while foreign currency spot transactions settled in 2 days).

<sup>42</sup> *See* Product Definition NPRM, 76 FR at 29827–29830, May 23, 2011.

<sup>35</sup> *See* note 6, above.

<sup>36</sup> This provision is the same antifraud language used in part 32 prior to the adoption of this final rule and interim final rule.

<sup>37</sup> The offeror, sometimes also called the grantor, is the seller of a commodity option.

<sup>38</sup> The offeree, sometimes also called the grantee, is the buyer of a commodity option.

<sup>39</sup> For example: Trade options would not contribute to, or be a factor in, the determination of whether a market participant is an SD or MSP; trade options would be exempt from the rules on mandatory clearing; and trade options would be

exempt from the rules related to real-time reporting of swaps transactions. The provisions identified in this footnote are not intended to constitute an exclusive or exhaustive list of the swaps requirements from which trade options are exempt.

<sup>40</sup> The existing trade option exemption, which the interim final rule trade option exemption would replace, includes no standards or requirements for option offerors.



conditions. The conditions are primarily intended to preserve a level of market visibility for the Commission while reducing the regulatory compliance burden for market participants.

#### i. Recordkeeping Pursuant to Part 45

These conditions include a recordkeeping requirement for any trade options activity, *i.e.*, the recordkeeping requirements of 17 CFR 45.2.<sup>43</sup> Such records must be maintained by all trade option participants pursuant to § 45.2 and made available to the Commission as specified therein.<sup>44</sup> Section 45.2 applies different recordkeeping requirements, depending on the nature of the counterparty. For example, if a trade option counterparty is an SD or MSP, it would be subject to the provisions of § 45.2(a). If a counterparty is neither an SD nor an MSP, it would be subject to the less stringent recordkeeping requirements of § 45.2(b). This recordkeeping condition will ensure that trade options market participants are able to provide pertinent information regarding their trade options activity to the Commission, if requested.

#### ii. Reporting Pursuant to Part 45

In addition to part 45 recordkeeping (which applies in some form to all trade options and trade option participants), the interim final rule requires certain trade options to be reported pursuant to part 45's reporting provisions. Under the interim final rule, the determination as to whether a trade option is required to be reported pursuant to part 45 is based on the parties to the trade option and whether or not they have previously reported swaps pursuant to part 45. Specifically, *if* any trade option involves

at least one counterparty (whether as buyer or seller) that has (1) Become obligated to comply with the reporting requirements of part 45, (2) as a reporting party, (3) during the twelve month period preceding the date on which the trade option is entered into, (4) in connection with any non-trade option swap trading activity, *then* such trade option must also be reported pursuant to the reporting requirements of part 45. If only one counterparty to a trade option has previously complied with the part 45 reporting provisions, as described above, then that counterparty shall be the part 45 reporting entity for the trade option. If both counterparties have previously complied with the part 45 reporting provisions, as described above, then the part 45 rules for determining the reporting party will apply.<sup>45</sup>

By applying the part 45 reporting requirements to trade options in this manner, the Commission will obtain greater transparency and improved oversight of the swaps markets, both of which are primary statutory objectives of Title VII of the Dodd-Frank Act. The Commission believes, however, that greater transparency regarding the trade options market must be balanced against the burdens of frequent and near-instantaneous reporting required under part 45 of the Commission's regulations on counterparties who are not otherwise obligated to report because they do not have other reportable swap activity. Accordingly, if neither counterparty to a trade option already is complying with the reporting requirements of part 45 as a reporting party in connection with its non-trade option swap trading activities as described above,<sup>46</sup> then such trade option is not required to be reported pursuant to the reporting requirements of part 45.<sup>47</sup>

#### iii. Annual Notice Filing Alternative to Part 45 Reporting; Form TO

To the extent that neither counterparty to a trade option has previously submitted reports to an SDR as a result of its swap trading activities as described above, the Commission recognizes that requiring these entities to report trade options to an SDR under part 45 of the Commission's regulations solely with respect to their trade options

activity would be costly and time consuming. As an alternative, the interim final rule requires any counterparty to an otherwise unreported trade option to submit an annual filing to the Commission for the purpose of providing notice that it has entered into one or more unreported trade options in the prior calendar year. Unlike with trade options subject to the part 45 reporting requirement, wherein only one counterparty to the trade option reports the transaction to an SDR, the notice filing requirement applies to both counterparties to an unreported trade option. Because the purpose of the notice filing requirement is to identify to the Commission those market participants engaging in unreported trade options, the notice filing requirement applies whether or not such counterparty has also been a non-reporting counterparty to a reported trade option in the twelve months preceding the date on which the unreported trade option was entered into. Market participants will satisfy the annual notice filing requirement by completing and submitting a new Commission form, Form TO, by March 1 following the end of any calendar year during which the market participant entered into one or more unreported trade options.

Form TO requires an unreported trade option counterparty to: (1) Provide name and contact information, (2) identify the categories of commodities (agricultural metals, energy, or other) underlying one or more unreported trade options which it entered into during the prior calendar year, and (3) for each commodity category, identify the approximate aggregate value of the underlying physical commodities that it either delivered or received in connection with the exercise of unreported trade options during the prior calendar year. For the purposes of item (3), a reporting counterparty should not include the value of commodities that were the subject of trade options that remained open at the end of the calendar year or any trade options that expired unexercised during the prior calendar year.

Pursuant to the interim final rule, Form TO is an annual filing requirement. The form must be submitted to the Commission no later than March 1 for the prior calendar year. For example, if a market participant enters into one or more unreported trade options between January 1, 2013 and December 31, 2013 (as will be discussed in the effective date and compliance date discussion, below, the first calendar year for which a Form TO will be due to the Commission is 2013), the

<sup>43</sup> The Commission recently adopted final swap data recordkeeping rules. See Swap Data Recordkeeping and Reporting Requirements 77 FR 2136, at 2198, Jan. 13, 2012.

<sup>44</sup> 17 CFR 45.2(h) provides that: [a]ll records required to be kept pursuant to this section [17 CFR 45.2] by any registrant or its affiliates or by any non-SD/MSP counterparty subject to the jurisdiction of the Commission shall be open to inspection upon request by any representative of the Commission, the United States Department of Justice, or the [SEC], or by any representative of a prudential regulator as authorized by the Commission. Copies of all such records shall be provided, at the expense of the entity or person required to keep the record, to any representative of the Commission upon request. Copies of records required to be kept by any registrant shall be provided either by electronic means, in hard copy, or both, as requested by the Commission, with the sole exception that copies of records originally created and exclusively maintained in paper form may be provided in hard copy only. Copies of records required to be kept by any non-SD/MSP counterparty subject to the jurisdiction of the Commission that is not a Commission registrant shall be provided in the form, whether electronic or paper, in which the records are kept.

<sup>45</sup> See 17 CFR 45.8.

<sup>46</sup> That is, neither counterparty to the trade option has previously reported, as the reporting party, non-trade option swap trading activity during the twelve months preceding the date on which the trade option is entered into.

<sup>47</sup> By taking this approach, the Commission ensures that no market participant is compelled to comply with part 45's reporting requirements based solely on its trade options activity.



market participant must submit a completed Form TO to the Commission on or before March 1, 2014. Form TO is set out in appendix A to part 32 of the Commission's regulations and will be available electronically on the Commission's Web site at least ninety days before the first compliance date for filing of that form, March 1, 2014. The Form TO filing requirement will provide the Commission a minimally intrusive level of visibility into the unreported trade options market, will guide the Commission's efforts to collect additional information through its authority to obtain copies of books or records required to be kept pursuant to the Act<sup>48</sup> should market circumstances dictate, and will enable the Commission to determine whether these counterparties should be subject to more frequent and comprehensive reporting obligations in the future.

#### iv. Specific Request for Comment on Trade Option Reporting and/or Notice Filing Requirements

The Commission is specifically requesting comment on including these part 45 recordkeeping and reporting compliance conditions, and the Form TO filing requirement for counterparties to unreported trade options, in connection with the interim final rule's trade option exemption. For example, what are the trade-offs between (1) reducing or removing the reporting requirement and/or notice filing requirement (and attendant costs) for smaller end-user and commercial entities and (2) the Commission's goals of maintaining market visibility and eliminating incentives or opportunities to avoid regulation? In their comments, market participants should identify alternatives, if any, to the part 45 recordkeeping and reporting requirements and/or the Form TO filing requirement as applicable to trade options participants. Commenters should explain how such alternatives may be able to provide the Commission with the equivalent market information and visibility it would receive pursuant to the part 45 requirements and/or the Form TO filing requirement, as applicable under the interim final rule, while lowering the compliance burden on market participants.

#### v. Swaps Large Trader Reporting; Position Limits

The interim final rule's trade option exemption also includes certain conditions referencing various other swaps rules, which rules shall remain applicable to trade options under this

interim final rule. Specifically, the following conditions, as set forth in interim final rule § 32.3(c), would apply to trade options (and trade option participants) to the same extent that such conditions would apply to any other swap (and swap counterparty): (1) Large trader reporting under part 20 (*i.e.*, reporting entities under part 20—SDs and clearing members—must consider their counterparty's trade option positions just as they would consider any other swap position for the purpose of determining whether a particular counterparty has a consolidated account with a reportable position, as set forth therein);<sup>49</sup> and (2) position limits under part 151 (to the extent a trade option position would otherwise be subject to the position limit rules).<sup>50</sup>

#### vi. SD/MSP Conditions

In addition, § 32.3(c) provides that certain provisions of subpart F and subpart J of part 23, relating to recordkeeping, reporting, and risk management duties of SDs and MSPs would apply to trade options.<sup>51</sup> SDs and MSPs participating in trade options will also remain subject to CEA section 4s(e), which addresses capital and margin requirements for SDs and MSPs. Each of these SD and MSP conditions simply confirms that an SD and/or MSP may not avoid certain requirements or obligations by structuring its swap transactions as trade options. SDs and MSPs may participate in trade options when they meet the underlying trade option offeror or offeree eligibility requirements, as applicable. But they will remain subject to the SD/MSP conditions identified in the interim final rule. As with the part 20 and part 151 conditions applicable to all trade options and trade options participants,

<sup>49</sup> 17 CFR part 20. Note that swap large trader reporting obligations apply only to SDs and clearing members. Trade option sellers and buyers (unless they fall within one of the part 20 reporting party categories) would not be responsible for filing large trader reports.

<sup>50</sup> 17 CFR part 151. Note that position limits apply only to speculative positions in those referenced contracts specified in part 151. Trade options, which are commonly used as hedging instruments or in connection with some commercial function, would normally qualify as hedges, exempt from the speculative position limit rules.

<sup>51</sup> Swap Dealer and Major Swap Participant Recordkeeping and Reporting, Duties, and Conflicts of Interest Policies and Procedures; Futures Commission Merchant and Introducing Broker Conflicts of Interest Policies and Procedures; Swap Dealer, Major Swap Participant, and Futures Commission Merchant Chief Compliance Officer, 77 FR 20128, Apr. 3, 2012. Note that these part 23 provisions, like the part 20 provisions, would only apply to certain large sophisticated entities—in this case, SDs and MSPs.

the SD/MSP conditions only apply in the context of trade options to the extent they would otherwise apply to the transaction as any other kind of swap (*i.e.*, as a non-trade option).

#### vii. Enforcement Provisions

Finally, at § 32.3(d), the interim final rule also retains for trade options the antifraud and anti-manipulation rules under part 180,<sup>52</sup> § 23.410,<sup>53</sup> the specific options antifraud provisions of pre-Dodd-Frank § 32.9 (renumbered herein as § 32.4), and any other general antifraud, anti-manipulation, and enforcement provisions of the CEA, including but not limited to, CEA sections 2, 4b, 4c, 4o, 4s(h)(1)(A), 4s(h)(4)(A), 6, 6c, 6d, 9, and 13.

#### viii. General Exemptive Authority Retained

The trade option exemption also contains general exemptive language that would permit the Commission, upon written request or upon its own motion, to exempt any other person, either unconditionally or on a temporary or other conditional basis, from any provisions of part 32 (other than the antifraud, anti-manipulation, and enforcement rules), or from the provisions of the Act, including any Commission rule, regulation, or order thereunder, otherwise applicable to any other swap, if the Commission finds, in its discretion, that it would not be contrary to the public interest to grant such exemption. This supplemental language tracks the general exemptive provision in the existing trade option exemption, and it will provide the Commission with the flexibility to receive and consider any concerns from market participants regarding the scope or implementation of the interim final rule trade option exemption.

#### D. Effective Date; Compliance Date

The commodity options final rule and interim final rule issued herein shall become effective 60 days after the publication of this document in the **Federal Register**.

The compliance date for the final rule and the interim final rule shall be 60 days after the term “swap” is further defined pursuant to section 721 of the Dodd-Frank Act (*i.e.*, 60 days after the further definition of “swap” is adopted by the Commission and the SEC and published in the **Federal Register**). However, for the purpose of complying with (1) final rule § 32.2(a), which permits entering into commodity options transactions in compliance with

<sup>52</sup> 17 CFR part 180.

<sup>53</sup> 17 CFR 23.410.

<sup>48</sup> See 17 CFR 1.31(a)(2) and 17 CFR 45.2(h).

and subject to the provisions of the Act, including any Commission rule, regulation, or order thereunder, otherwise applicable to any other swap, and (2) the conditions and provisions of the interim final rule trade option exemption under § 32.3, the compliance date for this final rule and interim final rule shall be the compliance date associated with any such swaps rules. That is, notwithstanding the effective or compliance dates identified herein, commodity options market participants need not comply with any applicable condition referencing a swap rule, regulation, or order, until such time as the rule, regulation, or order is applicable to any other swap. In addition, the first relevant compliance date for the Form TO notice filing requirement will be for the calendar year beginning January 1, 2013. That is, counterparties to unreported trade options are required to submit a Form TO in connection with their unreported trade options entered into between January 1 and December 31, 2013 on or before March 1, 2014. There is no Form TO filing requirement for unreported trade options entered into between the effective date of this rule and December 31, 2012.

#### V. Interim Final Rule Matters

This document implements regulations addressing the inclusion of commodity options in the Dodd-Frank Act definition of “swap.” Section 721 of the Dodd-Frank Act defines the term “swap” to include an option of any kind that is for the purchase or sale, or based on the value, of one or more commodities. The existing trade option exemption exempts certain trade options from the CEA almost entirely and was enacted pursuant to section 4c(b) of the CEA, which provides the CFTC with plenary authority to issue regulations related to commodity options. Such authority was not amended by the Dodd-Frank Act, and therefore, Congress continues to vest the Commission with plenary authority over commodity options. Prior to the Dodd-Frank Act, CFTC regulations provided for a trade option exemption, permitting the trading of qualifying transactions subject only to antifraud, anti-manipulation, and enforcement rules.<sup>54</sup> As discussed above, the Dodd-Frank Act defined commodity options as swaps. Accordingly, the CFTC proposed to amend the commodity options rules generally, and to specifically withdraw the trade option exemption, thereby providing that commodity options could transact subject to the same laws, rules,

regulations, and orders otherwise applicable to all other swaps, consistent with the Dodd-Frank Act. As explained in the comment summary above, the proposal requested comment regarding trade options and multiple commenters requested that the CFTC retain some form of a trade option exemption, particularly for physically delivered options. Therefore, in response to comments, and pursuant to its plenary authority over commodity options, the CFTC is implementing a revised trade option exemption, with certain conditions described above, through this interim final rule.

The CFTC nevertheless invites comments on this interim final rule and, when assessing whether to amend the interim final trade option exemption, will consider all timely comments submitted during the public comment period as described in the following section.

#### VI. Request for Comment on Interim Final Rule

In connection with the interim final rule's trade option exemption in § 32.3 adopted herein, the Commission requests comment on the following questions:

1. Generally, does the interim final rule issued herein provide an appropriate regulatory framework for trade options?
2. Regarding the trade option exemption, will such provision preserve appropriate hedging opportunities for current users of the trade options market? Is there any reason not to retain the trade option exemption as issued herein?
  - a. What types of entities offer trade options pursuant to the existing trade option exemption? Is the scope of the trade option exemption offeror requirement in the interim final rule (*i.e.*, offerors must be ECPs or commercials) appropriate? Alternatively, is this offeror requirement either too broad or too narrow?
  - b. Is the scope of the trade option exemption offeree requirement in the interim final rule (*i.e.*, offerees must be commercials) appropriate? Alternatively, is this offeree requirement either too broad or too narrow? Should ECPs that are not commercials be permitted as offerees? Why or why not?
  - c. Is the list of commercials described in the interim final rule (*i.e.*, a producer, processor, or commercial user of, or a merchant handling the commodity that is the subject of the commodity option transaction, or the products or by-products thereof) appropriate? Alternatively, is this description of

commercials either too broad or too narrow?

d. Is the range of commodity option transactions that would qualify for the trade option exemption appropriate?

i. By requiring that a trade option, when exercised, must result in the immediate (spot) or deferred (forward) shipment or delivery of an exempt or agricultural commodity, would the interim final rule improperly exclude other commodity option transactions, including other transactions with optionality, that should be eligible for a trade option exemption?

ii. In the alternative, is this physical delivery requirement of the trade option exemption too broad?

e. Should the interim final rule retain the general exemptive authority at § 32.3(e)?

f. In connection with § 32.3:

i. Is the requirement to comply with the part 45 recordkeeping rules for all trade option participants appropriate?

ii. Is the requirement that certain trade options be reported pursuant to the reporting provisions of part 45 appropriate?

1. Alternatively, should there be a *de minimis* threshold below which part 45 reporting would not apply to a trade option transaction and its participants (unless they are SDs/MSPs)?

2. If the response to the foregoing question is yes, should the *de minimis* threshold be based on the underlying transactions (volume, value, or some other measure), the participant characteristics, both, or some other measure? Where practicable, please identify a specific level at which a *de minimis* threshold may be set.

iii. In § 32.3(b)(1)(i), the Commission provides that trade options reporting for commodity options is required for counterparties that have become obligated to comply with the reporting requirements of part 45. The Commission understands that in some circumstances a counterparty that transacts trade options may not, itself, be obligated to report under part 45, but may be affiliated, at the enterprise or group level, with another entity that complies with part 45. There may be circumstances, therefore, where the obligation to report trade options would be more appropriately based on trade options activity and part 45 reporting at the enterprise or group level.

1. How often do cases occur in which a person that is subject to part 45 receives, in the ordinary course of business, transaction-level trade options information from a trade option counterparty affiliate that is not subject to part 45?

<sup>54</sup> See prior 17 CFR 32.4.

2. Should § 32.3(b)(1) be revised to account for such situations and, if so, how?<sup>55</sup>

iv. Is the requirement that counterparties to unreported trade options submit an annual notice filing, via Form TO, for the purpose of notifying the Commission that such counterparty entered into one or more unreported trade in the prior calendar year appropriate?

1. Alternatively, should these trade options be reported pursuant to part 45, notwithstanding that these counterparties do not otherwise comply with those requirements in connection with their swap trading activities? What would be the costs and benefits of this alternative condition? Please provide data and estimates to support your comments.

2. Should Form TO be required to be submitted more often (e.g., quarterly or monthly) and/or to require additional data fields (e.g., expired and/or open trade options and transaction specific data for each unreported trade option)? What would be the costs associated with requiring more frequent and/or more detailed filings? Please provide data and estimates to support your comments.

v. Is the swaps large trader reporting condition (part 20) appropriate for the trade option exemption?

vi. Is the position limit condition (part 151) appropriate for the trade option exemption?

vii. Are the SD and MSP recordkeeping, reporting, and risk management conditions, as applied via part 23, appropriate for SDs and MSPs transacting under the trade option exemption?

<sup>55</sup> For example, should the requirement in § 32.3(b)(1)(i) to report trade options extend to trade options counterparties that have become obligated to comply with the reporting requirements of part 45, or are affiliated with a person that is required to comply with the reporting requirements of part 45, provided that such an affiliate obtains through the ordinary course of business transaction-level information on the trade options entered into by the counterparty? An "affiliate" is a person that is either commonly owned or commonly controlled, consistent with existing CFTC affiliate rules. Two persons would be commonly owned affiliates if one party directly or indirectly holds a majority ownership interest in the other, or if a third party directly or indirectly holds a majority interest in both, based on holding a majority of the equity securities of an entity, or the right to receive upon dissolution the contribution of a majority of the capital of a partnership. Two persons are commonly controlled affiliates if either (1) one person possesses the power, directly or indirectly, to direct or cause the direction of the management and policies of the other person whether through the ownership of voting securities, by contract or otherwise or (2) a third person possesses the power, directly or indirectly, to direct or cause the direction of the management and policies of both persons whether through the ownership of voting securities, by contract or otherwise.

viii. Is the condition retaining the applicability of CEA section 4s(e) (Capital and Margin Requirements for SDs and MSPs) appropriate?

ix. Are the antifraud, anti-manipulation, and enforcement related conditions appropriate for the trade option exemption?

x. Since trade options have to be physically delivered and may only be offered to commercials for use in their business as such, does it make sense to exclude trade options from the calculation of whether or not a market participant is required to register as an SD or MSP? Alternatively, is there any reason to include trade options in the calculation of whether or not a market participant is required to register as an SD or MSP?

3. Does the interim final rule issued herein omit or fail to appropriately consider any other areas of concern regarding commodity options?

4. The Commission also invites comments on the costs and benefits considerations of the interim final rule under CEA section 15a, below. The Commission specifically requests that commenters quantify the costs and benefits, where practical.

Comments on these questions and the interim final rule must be submitted to the Commission, pursuant to the instructions provided above, on or before June 26, 2012.

## VII. Related Matters

### A. Cost Benefit Considerations

#### 1. Background

Prior to the passage of the Dodd-Frank Act, the Commission's regulations permitted certain commodity option transactions, including "trade options." As described above and in the NPRM, trade options are used by commercial entities entering into the commodity option transactions solely for purposes related to their business involving the commodity.<sup>56</sup> Buyers and sellers of trade options transact bilaterally off-exchange.<sup>57</sup>

Under the pre-Dodd-Frank regulatory construct, neither the buyer nor the seller of a commodity trade option were

<sup>56</sup> 76 FR 6095, 6102, Feb. 3, 2011 (*citing* 17 CFR 32.4(a)), which exempts a commodity option when it 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 by-products thereof, and that 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").

<sup>57</sup> See 17 CFR 32.4. See also 17 CFR part 35 as in effect prior to December 31, 2011. In addition, there was a stand-alone regulatory regime for agricultural trade options set forth in pre Dodd-Frank 17 CFR 32.13.

required to register with the Commission, maintain books and records, or report their transactions to the Commission in connection with their trade options activity. As a result, the current trade option market is opaque, affording virtually no regulatory visibility into its composition and scope.<sup>58</sup>

Congress altered the foundation for this regulatory construct in passing the Dodd-Frank Act, by, among other things, determining that the definition of "swap" would include, among other products, commodity options. Section 721 of the Dodd-Frank Act added section 1a(47) to the CEA, defining "swap" to include not only "any agreement, contract, or transaction commonly known as," among other things, "a commodity swap," but also "[an] option of any kind that is for the purchase or sale, or based on the value, of 1 or more \* \* \* commodities \* \* \*."<sup>59</sup> In addition, the Dodd-Frank Act mandated substantial changes in the swaps regulatory regime to reduce risk, increase transparency, and promote market integrity within the financial system.

This legislative act implicitly required the Commission to revisit its historical treatment of commodity options, including trade options. In so doing, the Commission is mindful that one of the purposes of the Dodd-Frank Act is to increase transparency of the financial markets, including the commodity options markets.

In response to the Dodd-Frank Act's definition of "swap" to include options, on February 3, 2011, the Commission published in the **Federal Register** a Notice of Proposed Rulemaking ("NPRM") that proposed to treat all commodity options (other than options on futures) as swaps. In the NPRM, the Commission proposed to require that all such commodity option transactions, including trade options, comply with the requirements that apply to swaps generally. While the NPRM received significant public comment, no commenter provided any quantitative data on costs or benefits.

Comments to the NPRM from the Energy Working Group typified commenters' concern that treating options on physical commodities like

<sup>58</sup> As discussed further below, as a consequence, the Commission is without reliable data from which to assess the size of the commodity options market or the number or types of market participants in it, which in turn makes quantification of the costs and benefits of this rulemaking largely impracticable.

<sup>59</sup> Section 1(a)(47) specifically excludes from the definition of "swap" any option on a contract of sale of a commodity for future delivery (i.e., options on futures traded on designated contract markets). See CEA section 1(a)(47)(B)(i).

any other swaps would impose significant costs:

Treating Physical Options transacted in such markets as “swaps” would create uncertainty and impose costly and duplicative regulatory requirements.<sup>60</sup>

[T]he Working Group sees no reason the Commission should not continue to treat Physical Options entered into by a commercial entity as commercial transactions exempt from the majority of the provisions of the CEA.<sup>61</sup>

And in specific response to the NPRM’s removal of the trade option exemption provided for in pre-Dodd-Frank § 32.4 of the Commission’s regulations, commenters urged the Commission to reconsider, as exemplified by the following comments from APGA and EEI-EPISA, respectively:

Although the Commission concludes that removal of the trade option exemption will have limited impact on market participants because of the swap end-user exemption, the regulatory requirements which would apply if these cash contracts are treated as though they are options would be enormous. First, characterizing these contracts as options would require compliance with all of the swap rules, including possibly requiring a natural gas producer whose only business is selling the physical product to register as a swap dealer.<sup>62</sup>

Regulations that make effective risk management tools and physical supply more costly for end-users of swaps and commodity options will result in higher and more volatile energy prices for retail, commercial, and industrial customers.<sup>63</sup>

The Commission also received specific comments requesting a trade option exemption for options that, if exercised, result in physical delivery.<sup>64</sup> Commenters also explained the need to retain a trade option exemption in the context of agricultural trade options.<sup>65</sup>

In this final rulemaking, the Commission is repealing and replacing the Commission’s regulations concerning commodity options. Upon consideration of the comments to the NPRM, the Commission also is adopting an interim final rule that incorporates an exemption for “trade options.”

In the discussion that follows, the Commission considers the costs and benefits of, and alternatives to, amending the regulations applicable to commodity options, including the trade option exemption that makes up the interim final rule, § 32.3; this interim final rule, the § 32.3 trade option

exemption, will operate as an alternative to the general commodity options authorization in § 32.2. The Commission considers these costs and benefits of its actions in the discussion that follows.

## 2. Statutory Mandate To Consider the Costs and Benefits of the Commission’s Action: CEA Section 15(a)

Section 15(a) of the CEA requires the Commission to consider the costs and benefits of its actions before promulgating a regulation under the CEA or issuing certain orders. Section 15(a) further specifies that the costs and benefits shall be evaluated in light of the following five broad areas of market and public concern: (1) Protection of market participants and the public; (2) efficiency, competitiveness and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations. The Commission considers the costs and benefits resulting from its own discretionary determinations with respect to the section 15(a) factors.

The costs and benefits associated with the inclusion of commodity options in the definition of swap in the Dodd-Frank Act are attributable to Congress, and therefore beyond the scope of the consideration of costs and benefits required by CEA section 15(a). The Commission considers the costs and benefits attributable to its actions in this rulemaking against the basic framework provided by the statute—in which options are swaps subject to all of the requirements attendant to that definition under the Dodd-Frank Act and the CEA (as amended by Dodd-Frank Act).

In proposing the rules, the Commission requested comment on all aspects of its cost benefit analysis, including the identification and assessment of any costs and benefits not discussed in our analysis, and data relevant to these costs and benefits. Several commenters provided comments on the costs and benefits of the proposal in qualitative terms, but none provided data from which to quantify costs and benefits.

The opacity with which trade options historically have been transacted affords the Commission no meaningful visibility with respect to the composition and scope of trade option activities necessary to quantify costs and benefits of this rulemaking. The lack of quantification in comments reinforces this conclusion and further demonstrates that there is no reasoned basis for determining how many commercials engage in commodity

options or, more specifically, trade options. In other words, there is no reliable information from which to assess the number of commercials that transact in commodity options today, or will do so in the future. There is also no way determine the number or type of entities that would choose to avail themselves of the trade option exemption that is the subject of this interim final rule. Notwithstanding these limitations, based on the comments received, it is apparent that commercials place great importance on the continued availability of a trade option exemption.

## 3. Benefits and Costs of the Final Rule

### a. Benefits

The purpose and primary benefit of the final rule is to align the Commission’s general commodity options provisions in part 32 with the Dodd-Frank swaps regime by providing, in general, that commodity options that are swaps (*i.e.*, commodity options other than options on futures) will be treated the same as all other swaps, with one exception: commodity options satisfying the terms of a revised trade option exemption. The final rule is permissive and administrative in nature, necessitated by the Commission’s plenary rulemaking authority over commodity options, which provides that: “No person shall offer to enter into, enter into or confirm the execution of, any transaction involving any commodity regulated under this chapter which is [a commodity option transaction], contrary to any rule, regulation, or order of the Commission prohibiting any such transaction or allowing any such transaction under such terms and conditions as the Commission shall prescribe.”<sup>66</sup> As discussed above, the final rule also permits DCM-traded options on underlying commodities, albeit under the provisions of new part 32 rather than existing part 33. New part 32 permits commodity options to trade subject to the same rules applicable to any other swap, and the Dodd-Frank Act permits swaps to be transacted on a DCM. These changes will further the public benefits Congress intended by applying the swaps statutory and regulatory regimes to commodity options generally.

### b. Costs

The Commission does not believe there are significant, if any, costs associated with the final rule relative to the requirements imposed by statute.

<sup>66</sup> See CEA section 4c(b).

<sup>60</sup> Energy Working Group at 2.

<sup>61</sup> Energy Working group at 11.

<sup>62</sup> APGA at 4.

<sup>63</sup> EEI-EPISA at 3.

<sup>64</sup> EEI-EPISA at 7–8.

<sup>65</sup> Commodity Options and Agricultural Swaps Working Group at 3–4.

This is so because the final rule does not, by itself, impose any substantive or administrative requirements on commodity option market participants. Rather, by adopting this final rule, the Commission provides the required general authorization for commodity options that are subject to the swap definition, and removes any uncertainty as to whether CEA section 4c(b) would otherwise prohibit such commodity options. This is not to say that there are no significant costs associated with transacting commodity options. Although not specific to this final rule, there are costs attendant to the various regulations applicable to transacting in commodity options, including the costs of recordkeeping and reporting requirements. Those costs, however, are discussed in the various swaps rules that impose the substantive requirements.<sup>67</sup>

#### 4. Interim Final Rule Benefits and Costs

##### a. Benefits

Under the CEA, as amended by the Dodd-Frank Act, the Commission is under no statutory obligation to issue an exemption for trade options. In fact, a plain reading of section 721 of the Dodd-Frank Act makes clear that all commodity options are swaps, without any special treatment of trade options. However, in light of the comments received, the Commission believes that retaining a trade option exemption is in the public interest.

The purpose and primary benefit of the interim final rule is that it preserves a means for hedging by commercial market participants through physically delivered options, albeit with important conditions and modifications from the existing trade option exemption. More specifically, the interim final rule provides a benefit (relative to the statutory requirements) in the form of a cost-saving exemption from certain swaps regulations for trade options on exempt and agricultural commodities as between certain commercial and financially-sophisticated counterparties. Additionally, the interim final rule benefits market participants that meet the conditions of the trade option exemption by eliminating the costs and inefficiencies that could result if the Commission were to pursue the

alternative of requiring entity- or product-specific requests for exemptive orders.<sup>68</sup>

##### b. Costs

Although we consider certain costs that may result from the interim final rule, and make comparisons to various alternatives, the Commission does not believe that the interim final rule will impose mandatory costs on any entity because the rule is exemptive, rather than prescriptive, and entities are not required to rely on it. Therefore, the Commission assumes that an entity will rely on the exemption only if the anticipated benefits warrant the costs attendant to the conditions the Commission is attaching to the exemption. Notwithstanding this assumption, the conditions on the trade option exemption may impose some costs on entities that choose to rely on it.

The interim final rule conditions the ability to transact trade options under the exemption on the following: offerors must be ECPs or commercials; offerees must be commercials; and the trade option, if exercised, must result in physical delivery.

Under the interim final rule, those relying on the trade option exemption must comply with certain regulatory requirements, including: Recordkeeping and reporting; position limits; and large trader reporting. While the conditions applicable to entities availing themselves of the trade option exemption—for example, compliance with position limits and large trader reporting, and subjection to the various enforcement provisions<sup>69</sup>—are part of this Commission action, most of the costs and benefits of those requirements are discussed in other rulemakings, or are otherwise not expected to be significant. The costs and benefits of the recordkeeping and reporting obligations are discussed elsewhere.<sup>70</sup> Moreover, reporting pursuant to the swaps large trader rules in part 20 will only be required for SDs and clearing members, and, based on the comments received on the NPRM, few trade option buyers are likely to fall within either of these categories. The speculative position limit rules of part 151 will only apply to trade options that involve “referenced

contracts” pursuant to the terms of part 151, and the Commission expects that most trade options entered into by commercial parties would be exempt from position limits in any event based on a position limit exemption for bona fide hedging transactions. The SD and MSP-specific conditions in the trade option exemption, which incorporate certain provisions from part 23, similarly do not impose any additional cost burden on SDs/MSPs beyond the retention of existing rules applicable to SDs/MSPs.

The costs attributable to the Commission’s exercise of discretion in this rulemaking—and that have not been considered in other rulemakings—are those generated by the reporting and recordkeeping requirements imposed upon commercials transacting in trade options but not otherwise reporting their transactions. This action should reduce costs relative to the basic statutory requirements (with no further action by the Commission) which would have subjected all trade options to the full array of regulatory requirements for swaps, including but not limited to part 45. However, the Commission requests information and estimates about the costs and benefits to market participants and the public that would result from requiring market participants to report on their trade options at two levels: (1) the enterprise or group level (as described in section VI, question 2(f)(iii), above), and (2) the person level as is provided for in the interim final rule at § 32.3(b)(1)(i).

##### c. Costs and Benefits as Compared to Alternatives

The range of alternative conditions available to the Commission with respect to who may transact trade options is wide—that is, the Commission could have decided that anyone or no one could be an offeror or offeree. Either of these extremes, however, would render almost meaningless either the exemption (if no one could be an offeror or an offeree) or the option element of the swap definition (if anyone could be an offeror or an offeree). Therefore, in striving to achieve the optimal balance of allowing those with a commercial need to hedge the price risk of a physical commodity while ensuring that there are enough market participants to provide the necessary liquidity to hedge that risk, the Commission determined to allow ECPs and non-ECP commercials to be offerors. On the offeror side, excluding commercial non-ECPs would have limited hedging opportunities available to non-ECPs who are active users of trade options as both buyers and sellers,

<sup>67</sup> E.g., Large Trader Reporting for Physical Commodity Swaps, 76 FR 43851, Sept. 20, 2011; Position Limits for Futures and Swaps, 76 FR 71626, Nov. 18, 2011; and Swap Dealer and Major Swap Participant Recordkeeping, Reporting, and Duties Rules; Futures Commission Merchant and Introducing Broker Conflicts of Interest Rules; and Chief Compliance Officer Rules for Swap Dealers, Major Swap Participants, and Futures Commission Merchants, 77 FR 20128, Apr. 3, 2012.

<sup>68</sup> Nevertheless, the Interim Final Rule does permit individuals to request exemptive orders on a case-by-case basis.

<sup>69</sup> See, e.g., Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices and Prohibition on Price Manipulation, 76 FR 41398, July 14, 2011.

<sup>70</sup> See Swap Data Recordkeeping and Reporting Requirements, 77 FR 2136, Jan. 13, 2012 (“Recordkeeping and Reporting Rules”).

depending on their commercial need. On the offeree side, the Commission considered it important to preserve the integrity of the trade options market for use by commercial users. If the rule had allowed entities other than commercial users to be buyers, the trade option market would be indistinguishable, arguably, from the general swaps market; there would be no connection between a buyer's purchase of a trade option, the trade option buyer's underlying commercial functions, and the buyer's commercial need to make and take delivery.

Similarly, the Commission could have elected to make the exemption available for trade options that, if exercised, result in either physical or financial settlement of the option. The Commission limited the condition to physical settlement out of a concern that if it allowed financial settlement, parties could evade the requirements otherwise applicable to swaps by merely labeling their transaction a trade option even though it was unrelated to their business as a commercial. The Commission notes, as did commenters, that the trade option exemption is rooted in a need by commercials to hedge the price risk of physical commodities, including but not limited to agricultural and energy commodities. Permitting financially-settled trade options would make this market, which is used for making or taking delivery of physical commodities needed for a commercial function, indistinguishable from the financial world of swaps and futures. In addition, and as noted above, commenters focused on the need for a trade option exemption specifically for physically delivered options. The Commission did not receive similar comments regarding financially settled transactions.

The Commission also had a range of alternatives with respect to regulatory requirements applicable to trade option transactions. For commercials, the Commission considered alternatives, ranging from requiring full compliance with part 45 to no requirements in light of its special call authority to request and obtain information. Given that one of the purposes of the Dodd-Frank Act is to increase market transparency and regulatory visibility into OTC markets, however, the Commission does not believe an exemption with no attendant recordkeeping or reporting requirements for commercials is a reasonable alternative.<sup>71</sup> At the same time, the

Commission believes that requiring full compliance with part 45's recordkeeping and reporting requirements by commercials would be unnecessary to achieve the desired and expected benefits of the interim final rule. Therefore, to mitigate the costs of compliance for otherwise non-reporting counterparties, the Commission is only requiring such counterparties to keep basic business records regarding their trade options transactions and to file an annual report with the Commission.<sup>72</sup>

The Commission believes that the recordkeeping requirement in the interim final rule may result in additional costs for commercials that currently do not maintain the now-required records. However, the Commission believes that most, if not all, commercials already retain the basic business records required by the new rule as a matter of good business practice. With respect to reporting, the Commission believes the form prescribed by the Commission for annual reports will entail some administrative and legal costs for such commercials.

Additionally, because the Commission believes that a distinction between agricultural commodities and other physical commodities is unwarranted, it is permitting agricultural trade options to rely on the revised general trade option exemption. The Commission declined to adopt the alternative that would have maintained this historically distinct treatment of trade options on agricultural commodities because, as commenter NGFA stated, the distinction was unwieldy and, consequently, the agricultural trade option (ATO) regime was largely unused.<sup>73</sup> The Commission also did not elect to carry over the \$10 million net worth restriction under the existing ATO exemption in § 32.13(g). The Commission anticipates that the new trade option exemption will create new hedging opportunities for a wide range of agricultural commercial market participants that have heretofore been precluded from entering into trade

effective market oversight and prosecution of violations by the Commission and other regulators" and that "[e]xperience with recordkeeping requirements in the context of futures suggests that all market participants are able to retain such records").

<sup>72</sup> The annual report would require counterparties to unreported trade options to provide: name and contact information; commodity categories (agricultural, metals, energy, or other); and approximate value (under \$10 million, \$10–100 million, over \$100 million) of commodities purchased or delivered in connection with options exercised during the prior calendar year.

<sup>73</sup> NGFA at 2.

options for agricultural commodities by that net worth restriction.

#### 5. Section 15(a) Factors (of the Final Rule and Interim Final Rule, as a Whole)

As noted above, in this final rule and interim final rule, the Commission considers the costs and benefits that result from the regulations issued herein.

##### a. Protection of Market Participants and the Public

The interim final rule trade option exemption will further the protection of market participants and the public by ensuring that trade options continue to be authorized, subject to recordkeeping and reporting requirements, large trader reporting and position limit requirements, certain SD/MSP rules, and explicit antifraud, anti-manipulation, and enforcement protections. These requirements will provide the Commission and the public with increased visibility into this marketplace and will protect market participants from fraudulent conduct by others. In the same way, the final rule permits commodity options, generally, subject to the rules and protections applicable to every other swap pursuant to the Dodd-Frank Act (and its related rulemakings).

##### b. Efficiency, Competitiveness, and Financial Integrity of the Markets

The trade option exemption provides an important hedging and risk management tool for commercial market participants, while also providing the Commission with vital visibility tools (*i.e.*, the recordkeeping and reporting requirements as well as the large trader reporting requirement) to help ensure the integrity of these markets. By permitting these valuable hedging and risk management tools, the Commission is facilitating the ability of market participants to hedge their risks more efficiently, since participants will have a larger set of hedging mechanisms available to them. In addition, providing a revised trade option exemption enhances competitiveness by continuing to provide market participants with a range of risk management choices. Finally, requiring option offerors to be ECPs or commercials enhances financial integrity by helping to assure that option grantors will have some minimal level of financial resources and sophistication, or will be commercial in nature, in order to reduce the risk that a seller would not be able to perform its obligations under a commodity option.

<sup>71</sup> See Recordkeeping and Reporting Rules, 77 FR at 2141, Jan. 13, 2012 (explaining that "[c]omplete records regarding each swap should be required from all counterparties, including non-SD/MSP counterparties to physical commodity swaps and other swaps, because such records are essential for

### c. Price Discovery

The trade options marketplace will continue to augment the exchange-traded financial markets in serving their price discovery function for a subject commodity. The Commission notes that there will be less price discovery for those trade options that are not otherwise required to meet the part 45 reporting requirements. Nevertheless, the Commission believes that the conditions discussed above should allow the trade options market to continue functioning in a manner that provides enough visibility to regulators. In addition, the Commission would have the authority to request and obtain additional information from trade option counterparties under its special call authority.

### d. Sound Risk Management Procedures

The comments received on the NPRM (discussed above) highlighted trade options as a fundamental risk management tool for commercial users of many physical commodities. By issuing the interim final rule trade option exemption, the Commission is facilitating the use of trade options by these commercial market participants in conjunction with the general Dodd-Frank swaps regime. Specifically, when exchange-traded products do not provide the appropriate coverage or scope in connection with a hedging need for a commercial market operation, the trade option exemption will allow for agreements to be tailored by the parties on a transaction-by-transaction basis in order to meet the physical delivery needs of a commodity for a given commercial purpose. As noted above, the final rule provides an equally important component of the derivatives market (and a tool for risk management) by retaining a general authority for commodity options that are not trade options.

### e. Other Public Interest Considerations

The Commission believes that providing the revised trade option exemption, in conjunction with the general authorization for all commodity options, is consistent with the public interest (particularly as demonstrated by the commenters) in providing effective and efficient risk management tools to commercial market participants, as well as in providing a strong legal framework for the trade options and general options market. The Commission acknowledges that the revised trade option exemption will remove those swaps that fall within it from certain aspects of the Dodd-Frank regime to which they otherwise would be subject. Nevertheless, based

on its historical experience regulating commodity options, and the proven past utility of a trade option exemption for physical delivery options used by commercial parties, the Commission believes that exercise of its CEA section 4c(b) plenary authority to exempt trade options in the interim final rule is appropriate and benefits the public interest. In addition, the recordkeeping and reporting requirements, as well as the other conditions discussed above, should allow the trade options market to continue functioning in a manner that provides sufficient visibility to regulators.

### 6. Request for Comment on CBC in Connection With Interim Final Rule

After considering the section 15(a) factors, the Commission has determined to issue part 32 and the amendments to part 33 as described herein. The Commission invites public comment on its cost-benefit considerations in connection with the interim final rule trade option exemption. Commenters are encouraged to submit any data or other information that they may have quantifying or qualifying the costs and benefits of the interim final rule trade option exemption with their comment letters. In addition, the Commission seeks comment on whether the offeror requirement imposes any additional costs, particularly when compared with the general Dodd-Frank swaps regime, which does not otherwise provide for the trade option classification, and whether limiting the trade option exemption to physically delivered contracts (and requiring all other commodity options to transact under the general swaps rules) imposes any significant or unreasonable cost on market participants.

### B. Regulatory Flexibility Analysis

The Regulatory Flexibility Act ("RFA") requires that agencies consider whether the rules they issue will have a significant economic impact on a substantial number of small entities and, if so, provide a regulatory flexibility analysis respecting the impact.<sup>74</sup> The final rule, in amending part 33, would affect entities that currently engage in options on physical commodities on a DCM, and the final rule and interim final rule, in replacing part 32, would affect those entities that currently engage in options under § 32.4 and § 32.13(g). By generally mandating that commodity options be treated as all other swaps, with one exemption for trade options, the effect of the rules has the potential to affect designated

contract markets ("DCMs"), derivatives clearing organizations ("DCOs"), futures commission merchants ("FCMs"), large traders and eligible contract participants ("ECPs"), as well as SDs, MSPs, commodity pool operators ("CPOs"), swap execution facilities ("SEFs"), swap data repositories ("SDRs"), and certain non-ECP commercial market participants that enter into trade options.

#### 1. DCMs, DCOs, FCMs, CPOs, large traders, ECPs, and ESP

The Commission has previously determined that DCMs, DCOs, FCMs, CPOs, large traders, ECPs, and eligible swap participants ("ESPs") are not small entities for purposes of the Regulatory Flexibility Act.<sup>75</sup> Accordingly, the Chairman, on behalf of the Commission, hereby certifies pursuant to 5 U.S.C. 605(b) that the final and interim final rules adopted herein will not have a significant economic impact on a substantial number of small entities with respect to these entities.

The Commission received one comment from the Power Coalition asserting that certain of its member entities may both be ECPs under the CEA and small businesses under the RFA. These members, as the Commission understands, have been determined to be small entities by the Small Business Administration ("SBA") because they are "primarily engaged in the generation, transmission, and/or distribution of electric energy for sale and [their] total electric output for the preceding fiscal year did not exceed 4 million megawatt hours."<sup>76</sup> For all entities that may both be ECPs and have been determined by the SBA to be small businesses under the RFA, the initial regulatory flexibility analysis in the proposed rulemaking and the final regulatory flexibility analysis, in subsection "5" below, discusses the impact of the rulemaking on small entities.

#### 2. SDs, MSPs, SEFs, and SDRs

SDs, MSPs, SEFs, and SDRs are new categories of registrant under the Dodd-Frank Act. Pursuant to various Dodd-Frank rulemakings, the Commission has determined that SDs, MSPs, SEFs, and SDRs are not "small entities" for purposes of the RFA.<sup>77</sup> Accordingly, the

<sup>75</sup> See, respectively and as indicated, 47 FR 18618, 18619, Apr. 30, 1982 (DCMs, CPOs, FCMs, and large traders); 66 FR 45604, 45609, Aug. 29, 2001 (DCOs); 66 FR 20740, 20743, Apr. 25, 2001 (ECPs); and 57 FR 53627, 53630, Nov. 12, 1992 and 58 FR 5587, 5593, Jan. 22, 1993 (ESPs).

<sup>76</sup> Small Business Administration, *Table of Small Business Size Standards*, (Nov. 5, 2010).

<sup>77</sup> See respectively, Registration of Swap Dealers and Major Swap Participants, 77 FR 2613, 2620,

<sup>74</sup> See 5 U.S.C. 601 *et seq.*



Chairman, on behalf of the Commission, hereby certifies pursuant to 5 U.S.C. 605(b) that the final and interim final rules adopted herein, with respect to SDs, MSPs, SEFs, and SDRs, will not have a significant impact on a substantial number of small entities.

### 3. Entities Eligible To Engage in Options on Physical Commodities on DCMs Under Part 33

Under the current part 33, there is no regulatory financial threshold that must be met in order to engage in options on underlying commodities on a DCM, so small entities would be eligible to engage in such transactions. In fact, there is no regulatory financial threshold that must be met in order to engage in any type of transaction on a DCM. As noted above, new CEA section 1a(47) provides that options, other than options on futures, are swaps. New CEA section 2(e) provides that non-ECPs may enter into swaps, if the swaps are entered into on a DCM. Therefore, even though an option on an underlying commodity is defined to be a swap under the Dodd-Frank Act, small entities will continue to be eligible to enter into such options on a DCM under the rules issued herein, just as they are eligible to enter into such options on a DCM under the current part 33. Thus, the final and interim final rules will have no effect on the eligibility of small entities to enter into an option on an underlying commodity on a DCM. Accordingly, the Chairman, on behalf of the Commission, hereby certifies pursuant to 5 U.S.C. 605(b) that the final and interim final rules will not have a significant economic impact on a substantial number of small entities with respect to entities eligible to engage in options on underlying commodities on DCMs under part 33.

### 4. Entities Engaged in Options Under § 32.13(g)

The Commission addressed the question of whether entities engaged in agricultural trade options under § 32.13(g) are, in fact, “small entities” for purposes of the RFA in the NPRM. In the NPRM, the Commission determined that entities engaged in options under § 32.13(g) were not small entities.<sup>78</sup> As noted above, the Commission previously has determined that ECPs are not small entities for the

purpose of the RFA based upon, among other things, the financial and institutional requirements contained in the definition. Also as noted above, the exemption at § 32.13(g) allows for options on the enumerated agricultural commodities to be sold when: (1) The option is offered to a commercial (“a producer, processor, or commercial user of, or a merchant handling” the underlying commodity); (2) the commercial enters the transaction solely for purposes related to its business as such; and (3) each party to the option contract has a net worth of not less than \$10 million. There are two analogous provisions in the ECP definition, new CEA sections 1a(18)(A)(v)(III) and 1a(18)(A)(xi)(II). New CEA section 1a(18)(A)(v)(III) provides that an ECP includes a corporation, partnership, proprietorship, organization, trust, or other entity that has a net worth exceeding \$1,000,000 and enters into a swap in connection with the entity’s business or to manage the risk associated with an asset or liability owned or incurred or reasonably likely to be owned or incurred by the entity in the conduct of the entity’s business. New CEA section 1a(18)(A)(xi)(II) provides that an ECP includes an individual who has assets invested on a discretionary basis, the aggregate of which is in excess of \$5,000,000 and who enters the swap in order to manage the risk associated with an asset owned or liability incurred, or reasonably likely to be owned or incurred, by the individual. The participation requirements of § 32.13(g)(1) are similar to, if not more restrictive than, the analogous ECP provisions.

For purposes of the RFA in this rulemaking, the Commission is hereby determining that entities engaged in options under § 32.13(g) are not considered to be “small entities” for essentially the same reasons that ECPs have previously been determined not to be small entities. Accordingly, the Chairman, on behalf of the Commission, hereby certifies pursuant to 5 U.S.C. 605(b) that the final and interim final rules, with respect to entities engaged in options under § 32.13(g), will not have a significant impact on a substantial number of small entities.

### 5. Entities Engaged in Options Under Existing § 32.4

In the NPRM, the Commission initially addressed the question of whether entities engaged in trade options under the existing trade options rule are, in fact, “small entities” for purposes of the RFA.<sup>79</sup> As noted above,

under the existing trade options rule, an option must be offered to a producer, processor, or commercial user of, or a merchant handling, the commodity, who enters into the commodity option transaction solely for purposes related to its business as such. The existing trade option exemption does not include any net worth requirement.

Because there is no net worth requirement in the existing trade option rule, thus allowing commercial entities of any economic status to enter into trade option transactions, the Commission is not in a position to determine whether entities engaged in options under the existing trade option rule include a substantial number of small entities on which the rule would have a significant economic impact. Therefore, the Commission provided an initial regulatory flexibility analysis in the NPRM addressing the proposed withdrawal of the existing trade option exemption on small entities. In the NPRM, the Commission identified the small entities that would be affected by the proposed withdrawal as any commercial small entity that would be smaller than an ECP and additionally would have annual receipts of less than \$750,000.<sup>80</sup>

As referenced above, the Commission received a comment from the Power Coalition that may indicate that certain of their members, in particular entities that are “primarily engaged in the generation, transmission, and/or distribution of electric energy for sale and [their] total electric output for the preceding fiscal year did not exceed 4 million megawatt hours,” have been determined by the SBA to be small entities. Such entities may enter into option transactions, though the Commission does not have sufficient information to determine that any such entities would constitute a substantial number of small entities for purposes of the RFA.

Moreover, for those entities that may enter into option transactions that would be ECPs with annual receipts greater than \$750,000, but that also may be small entities as determined by SBA, it was not indicated in comments to the initial regulatory flexibility analysis that the effect of the proposed rulemaking would be any greater for these entities than for the smaller entities the Commission identified in the initial analysis. Indeed, on a relative basis, the larger the entity, the less of an effect the rulemaking should have. Critically, unlike a non-ECP, which will be unable to engage in option transactions except

Jan. 19, 2012 (swap dealers and major swap participants); Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities Regarding the Mitigation of Conflicts of Interest, 75 FR 63732, 63745, Oct. 18, 2010 (SEFs); and Swap Data Repositories, 75 FR 80898, 80926, Dec. 23, 2010 (SDRs).

<sup>78</sup> See 76 FR 6095, at 6107, Feb. 3, 2011.

<sup>79</sup> See 76 FR 6095, at 6017–6018, Feb. 3, 2011.

<sup>80</sup> 5 U.S.C. 601(6) (threshold for certain agricultural entities under the RFA).

on a DCM, and (if a commercial) through trade options, an entity that is both an ECP, as that term is defined in the CEA, and a small entity, as determined by the SBA, will not be so restricted.

Therefore, the Commission offers, pursuant to 5 U.S.C. 604, the following final regulatory flexibility analysis:

- A description of the reasons why action by the agency is being considered.

The Commission is taking this regulatory action to withdraw the existing trade option exemption because the Dodd-Frank Act has defined the term “swap” to include options. This new definition renders the existing trade option exemption obsolete in its current form. Responding to comments received on its NPRM, a revised trade option exemption is being issued as interim final rule § 32.3.

- A succinct statement of the objectives of, and legal basis for, the rule.

The objective for issuing interim final rule § 32.3, is to make the Commission’s regulations comport with the CEA as revised by the Dodd-Frank Act. As stated previously, the legal basis for the rule is the CEA definition of swap, section 1a(47)(A)(i), and the Commission’s plenary options authority, CEA section 4c(b).

- A description of and, where feasible, an estimate of the number of small entities to which the rule will apply.

The small entities to which the withdrawal of the trade option exemption and issuance of the final rule may apply are those commercial small entities that would be smaller than an ECP and additionally would have annual receipts of less than \$750,000, or those commercial entities that would be an ECP with annual receipts of greater than \$750,000 but that have been determined by SBA to be a small entity by virtue of the level of total electric output for the preceding fiscal year or equivalent metrics that would result in the entity being a small entity under the RFA.<sup>81</sup> Because there are no reporting or registration requirements in the existing trade option exemption, it is difficult to quantify the exact number of small entities, if any, to which the rule may apply, and whether such entities in the aggregate would constitute a substantial number of small entities compared to the universe of entities to which the rule

could apply. However, the impact, if any, is largely mitigated by the inclusion of interim final rule § 32.3, a revised trade option exemption that will continue to be available for small entities that are, generally speaking, commercial actors entering into a commodity option for commercial purposes—including non-ECPs.

- A description of the projected reporting, recordkeeping, and other compliance requirements of the rule, including an estimate of the classes of small entities which will be subject to the requirement and the type of professional skills necessary for preparation of the report or record.

The withdrawal of the existing trade option exemption does not impose any reporting, recordkeeping, or other compliance requirements. However, because the Dodd-Frank Act provides that options are swaps, the swaps rules being promulgated under the Dodd-Frank Act in other rulemakings will contain reporting, recordkeeping, and other compliance requirements. In addition, the interim final rule trade option exemption at § 32.3, issued herein, includes certain compliance obligations. However, those conditions do not impose any significant burden or requirement on a small entity that has not been or will not be imposed through another rulemaking, for which the Commission has, in its discretion, addressed RFA compliance separately,<sup>82</sup> or by self-execution of the CEA as amended by the Dodd-Frank Act.

For example, the large trader reporting condition references part 20, and would only fall on part 20 reporting entities, SDs and clearing members, and not on any small entity. The position limits condition would only apply part 151 position limits to the same extent they would apply to any other swap transaction entered into by the small entity. The SD/MSP rules from part 23 only apply to SDs and MSPs and not to any small entity. The antifraud and anti-manipulation condition has and will always apply to every entity transacting under the Commission’s jurisdiction. In addition, the part 45 recordkeeping and reporting requirements in the trade option exemption generally only require recordkeeping and reporting to the same extent that such rules apply to any other swap, which the Commission has determined does not constitute a significant new burden as applied in the context of this rulemaking.

The new Form TO annual notice filing requirement further mitigates the burden of the reporting requirement for counterparties who only engage in

unreported trade options. The form is necessary to give the Commission at least a general overview, for market surveillance purposes, of the counterparties engaging in otherwise unreported trade options, and the types and approximate value of the commodities involved in such options. The form also provides contact information in case Commission surveillance staff needs to contact trade option counterparties to seek more detailed information regarding market events. While Form TO is a new form, and thus a new requirement for those required to file, it is a single annual filing, seeking very general and easily accessible information. The alternative to using form TO would be to apply the full part 45 reporting regulations.

- An identification, to the extent practicable, of all relevant Federal rules which may duplicate, overlap or conflict with the rule.

Small entities that do not qualify as ECPs will be unable to engage in options transactions except on a DCM under an existing regulatory scheme, or if commercials, pursuant to the new trade option exemption in interim final rule § 32.3. The trade option exemption at interim final rule § 32.3 may be relied upon by a non-ECP that is a producer, processor, or commercial user of, or a merchant handling the commodity that is the subject of the commodity option transaction, or the products or by-products thereof, and that is offering or entering into the commodity option transaction solely for purposes related to its business as such. This provision will continue to permit many transactions that currently transact pursuant to the existing trade option exemption. The primary significant new requirement for trade options participants is the application of the recordkeeping and reporting requirement of part 45 (as well as the other trade option conditions, discussed above), and/or the Form TO notice filing requirement. Accordingly, there will be no rules applicable to the small entities, under the interim final rule trade option exemption, that duplicate, overlap, or conflict with any other Federal rules.

- Description of any significant alternatives to the rule which accomplish the stated objectives of applicable statutes and which minimize any significant economic impact of the rule on small entities.

These may include, for example: (1) The establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities; (2) the clarification, consolidation, or simplification of compliance and

<sup>81</sup> 5 U.S.C. 601(6). See also note 76, above, which relates to the Power Coalition’s concern that certain entities that meet or exceed the CEA’s ECP thresholds may still be small entities for purposes of the RFA. This initial regulatory flexibility analysis applies equally to such entities.

<sup>82</sup> See 5 U.S.C. 605(c).

reporting requirements under the rule for such small entities; (3) the use of performance rather than design standards; and (4) an exemption from coverage of the rule, or any part thereof, for such small entities.

A potential alternative to limiting trade options under the existing trade option exemption to the requirements under interim final rule § 32.3 (*i.e.*, commercial participants and physically settled options) would be to either (1) delete the existing trade option and not replace it, or (2) create a special rule to allow any non-ECP to engage in such transactions and to allow such transactions to be either physically or financially settled. As explained in this document, and as stressed by the commenters, to adopt option (1) as a final rule (deleting the trade option provision altogether) would have been prohibitively costly and would have had a significant negative impact on hedging opportunities available to small entities. With regard to option (2), and as described above, interim final rule § 32.3 provides an exemption for certain commercial parties entering into physical commodity options for commercial purposes. Based on the comments received in response to the NPRM, discussed above, the Commission has determined that to treat all trade options in the same manner as any other swap (including permitting commodity options for all participants on a DCM), with the addition of the trade option exemption at § 32.3, will provide an appropriate and flexible framework for the overwhelming majority of commodity options participants that will seek to rely on the trade option exemption. In addition, to retain a trade option exemption with no participant requirements and no physical delivery requirement would potentially undermine many of the market and consumer protections embodied in the swaps provisions of the Dodd-Frank Act.

### C. Paperwork Reduction Act

The purposes of the Paperwork Reduction Act of 1995, 44 U.S.C. 3501 *et seq.* ("PRA") are, among other things, to minimize the paperwork burden to the private sector, ensure that any collection of information by a government agency is put to the greatest possible uses, and minimize duplicative information collections across the government.<sup>83</sup> The PRA applies to all information, "regardless of form or format," whenever the government is "obtaining, causing to be obtained [or] soliciting" information, and includes

required "disclosure to third parties or the public, of facts or opinions," when the information collection calls for "answers to identical questions posed to, or identical reporting or recordkeeping requirements imposed on, ten or more persons."<sup>84</sup> The PRA requirements have been determined to include not only mandatory but also voluntary information collections, and include both written and oral communications.<sup>85</sup> Under the PRA, an agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number from the Office of Management and Budget ("OMB"). With the exception of the new Form TO annual notice filing requirement, discussed below, the Commission believes that these rules will not impose any new information collection requirements that require approval of OMB under the PRA. The Commission notes that these rules will involve the withdrawal of certain provisions related to Commission forms, and will ultimately result in the expiration, cancellation, or removal of such forms.<sup>86</sup> Because the rules would ultimately result in removing or deleting form filing and/or recordkeeping burdens, they will not result in the creation of any new information collection subject to OMB review or approval under the PRA, except for the new Form TO annual notice filing requirement discussed below. As a general matter, these rules would allow commodity options to trade under the same terms and conditions as all other swaps and these rules do not, by themselves, impose any new information collection requirements other than those that exist or have been proposed in the Commission's general swap-related Dodd-Frank rulemakings. The same analysis applies with respect to the general conditions applicable under the trade option exemption in § 32.3(b)—which conditions would only apply to the same extent they would apply to any other swap. Similarly, the application of the part 45 recordkeeping and reporting requirements to trade options, via interim final rule § 32.3(b), only imposes such requirements to the same extent they would apply to any other swap. That is, these specific recordkeeping and reporting costs have been accounted for in the information

collection prepared by the Commission with respect to its part 45 rules. Also, collections of information that may be associated with engaging in commodity options or trade options are, or will be, addressed within each of the general swap-related rulemakings implementing the Dodd-Frank Act.<sup>87</sup> To avoid creating duplicative PRA estimates, the Commission is not accounting again for those costs with respect to this rulemaking. Therefore, this final rule and interim final rule do not constitute a new collection of information by the Commission, other than those that may be associated with the new Form TO annual notice filing requirement.

As noted above, the interim final rule imposes a new Form TO annual notice filing requirement on counterparties to unreported trade options, which requirement is considered to be a collection of information within the meaning of the PRA. The Commission therefore is required to submit to OMB an information collection request for review and approval in accordance with 44 U.S.C. 3506(c)(2)(A) and 5 CFR 1320.8(d). The Commission will, by separate action, publish in the **Federal Register** a notice and request for comment on the paperwork burden associated with the interim final rule's Form TO annual notice filing requirement in accordance with 5 CFR 1320.8 and 1320.10. If approved, this new collection of information will be mandatory. As noted above, the Form TO annual notice filing would not be due to the Commission for the first time until March 1, 2014, for counterparties that enter into one or more unreported trade options during the 2013 calendar year.

The Commission specifically invites public comment on the accuracy of its estimate that no additional information collection requirements or changes to existing collection requirements, other than Form TO, would result from the interim final rule trade option exemption issued herein.

<sup>87</sup> See, e.g., Position Limits for Futures and Swaps, 76 FR 71626 at 71680–71683, Nov. 18, 2011; Large Trader Reporting for Physical Commodity Swaps, 76 FR 43851 at 43860–43862, July 22, 2011; Swap Data Recordkeeping and Reporting Requirements 77 FR 2136, at 2171–2176, Jan. 13, 2012; and Swap Dealer and Major Swap Participant Recordkeeping and Reporting, Duties, and Conflicts of Interest Policies and Procedures; Futures Commission Merchant and Introducing Broker Conflicts of Interest Policies and Procedures; Swap Dealer, Major Swap Participant, and Futures Commission Merchant Chief Compliance Officer, 77 FR 20128, Apr. 3, 2012.

<sup>84</sup> See 44 U.S.C. 3502.

<sup>85</sup> See 5 CFR 1320.3(c)(1).

<sup>86</sup> This includes any forms that relate to the agricultural trade option rules in current 17 CFR 32.13 and the dealer option rules in current 17 CFR 32.12.

<sup>83</sup> See 44 U.S.C. 3501.

**VIII. Final Rule and Interim Final Rule****List of Subjects***17 CFR Part 3*

Administrative practice and procedure, Brokers, Commodity futures, Reporting and recordkeeping requirements.

*17 CFR Part 32*

Commodity futures, Consumer protection, Fraud, Reporting and recordkeeping requirements.

*17 CFR Part 33*

Commodity futures, Consumer protection, Fraud, Reporting and recordkeeping requirements.

In consideration of the foregoing and pursuant to the authority contained in the Act, as indicated herein, the Commission hereby amends chapter I of title 17 of the Code of Federal Regulations as follows:

**PART 3—REGISTRATION**

■ 1. The authority citation for part 3 continues to read as follows:

**Authority:** 5 U.S.C. 522, 522b; 7 U.S.C. 1a, 2, 6, 6a, 6b, 6c, 6d, 6e, 6f, 6g, 6h, 6i, 6k, 6m, 6n, 6o, 6p, 6s, 8, 9, 9a, 12, 12a, 13b, 13c, 16a, 18, 19, 21, and 23, as amended by Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111–203, 124 Stat. 1376 (July 21, 2010).

**§ 3.13 [Removed and Reserved]**

■ 2. Remove and reserve § 3.13.

■ 3. Revise part 32 to read as follows:

**PART 32—REGULATION OF COMMODITY OPTION TRANSACTIONS**

Sec.

32.1 Scope.

32.2 Commodity option transactions; general authorization.

32.3 Trade options.

32.4 Fraud in connection with commodity option transactions.

32.5 Option transactions entered into prior to the effective date of this part.

Appendix A to 17 CFR Part 32

**Authority:** 7 U.S.C. 1a, 2, 6c, and 12a, unless otherwise noted.

**§ 32.1 Scope.**

The provisions of this part shall apply to all commodity option transactions, except for commodity option transactions on a contract of sale of a commodity for future delivery conducted or executed on or subject to the rules of either a designated contract market or a foreign board of trade.

**§ 32.2 Commodity option transactions; general authorization.**

Subject to §§ 32.1, 32.4, and 32.5, which shall in any event apply to all

commodity option transactions, it shall be unlawful for any person or group of persons to offer to enter into, enter into, confirm the execution of, maintain a position in, or otherwise conduct activity related to any transaction in interstate commerce that is a commodity option transaction, unless:

(a) Such transaction is conducted in compliance with and subject to the provisions of the Act, including any Commission rule, regulation, or order thereunder, otherwise applicable to any other swap, or

(b) Such transaction is conducted pursuant to § 32.3.

**§ 32.3 Trade options.**

(a) Subject to paragraphs (b), (c), and (d) of this section, the provisions of the Act, including any Commission rule, regulation, or order thereunder, otherwise applicable to any other swap shall not apply to, and any person or group of persons may offer to enter into, enter into, confirm the execution of, maintain a position in, or otherwise conduct activity related to, any transaction in interstate commerce that is a commodity option transaction, *provided that:*

(1) Such commodity option transaction must be offered by a person that has a reasonable basis to believe that the transaction is offered to an offeree as described in paragraph (a)(2) of this section. In addition, the offeror must be either:

(i) An eligible contract participant, as defined in section 1a(18) of the Act, as further jointly defined or interpreted by the Commission and the Securities and Exchange Commission or expanded by the Commission pursuant to section 1a(18)(C) of the Act; or

(ii) A producer, processor, or commercial user of, or a merchant handling the commodity that is the subject of the commodity option transaction, or the products or by-products thereof, and such offeror is offering or entering into the commodity option transaction solely for purposes related to its business as such;

(2) The offeree must be a producer, processor, or commercial user of, or a merchant handling the commodity that is the subject of the commodity option transaction, or the products or by-products thereof, and such offeree is offered or entering into the commodity option transaction solely for purposes related to its business as such; and

(3) The commodity option must be intended to be physically settled, so that, if exercised, the option would result in the sale of an exempt or agricultural commodity for immediate or deferred shipment or delivery.

(b) In connection with any commodity option transaction entered into pursuant to paragraph (a) of this section, every counterparty shall comply with the swap data recordkeeping requirements of part 45 of this chapter, as otherwise applicable to any swap transaction, and shall:

(1) Comply with the swap data reporting requirements of part 45 of this chapter to the extent that the commodity option involves at least one counterparty (whether as offeror or offeree) that has—

(i) Become obligated to comply with the reporting requirements of part 45,

(ii) As a reporting party,

(iii) During the twelve month period preceding the date on which the trade option is entered into,

(iv) In connection with any non-trade option swap trading activity; or

(2) For any counterparty that enters into one or more commodity options pursuant to § 32.3(a) in a calendar year that do not involve a counterparty described in paragraph (b)(1) of this section, file with the Commission by March 1 of the following year an “Annual Notice Filing for Counterparties to Unreported Trade Options” on Form TO, as set forth in Appendix A to this part, to be completed and submitted in accordance with the instructions thereto and as further directed by the Commission.

(c) In connection with any commodity option transaction entered into pursuant to paragraph (a) of this section, the following provisions shall apply to every trade option counterparty to the same extent that such provisions would apply to such person in connection with any other swap:

(1) Part 20 (Swaps Large Trader Reporting) of this chapter;

(2) Part 151 (Position Limits) of this chapter;

(3) Subpart J of part 23 (Duties of Swap Dealers and Major Swap Participants) of this chapter;

(4) Sections 23.200, 23.201, 23.203, and 23.204 of subpart F of part 23 (Reporting and Recordkeeping Requirements for Swap Dealers and Major Swap Participants) of this chapter; and

(5) Section 4s(e) of the Act (Capital and Margin Requirements for Swap Dealers and Major Swap Participants).

(d) In addition, any person or group of persons offering to enter into, entering into, confirming the execution of, maintaining a position in, or otherwise conducting activity related to a commodity option transaction in interstate commerce pursuant to paragraph (a) of this section shall remain subject to part 180 (Prohibition

Against Manipulation) and § 23.410 (Prohibition on Fraud, Manipulation, and other Abusive Practices) of this chapter and the antifraud, anti-manipulation, and enforcement provisions of CEA sections 2, 4b, 4c, 4o, 4s(h)(1)(A), 4s(h)(4)(A), 6, 6c, 6d, 9, and 13.

(e) 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, and the provisions of the Act, including any Commission rule, regulation, or order thereunder, otherwise applicable to any other swap, other than § 32.4, part 180 (Prohibition Against Manipulation), and

§ 23.410 (Prohibition on Fraud, Manipulation, and other Abusive Practices) of this chapter, and the antifraud, anti-manipulation, and enforcement provisions of CEA sections 2, 4b, 4c, 4o, 4s(h)(1)(A), 4s(h)(4)(A), 6, 6c, 6d, 9, 13, if it finds, in its discretion, that it would not be contrary to the public interest to grant such exemption.

**§ 32.4 Fraud in connection with commodity option transactions.**

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

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

**§ 32.5 Option transactions entered into prior to the effective date of this part.**

Nothing contained in this part shall be construed to affect any lawful activities that occurred prior to the effective date of this part.

**Appendix A to 17 CFR Part 32**

**BILLING CODE P**

# CFTC FORM TO

## Annual Notice Filing for Counterparties to Unreported Trade Options<sup>88</sup>



**NOTICE:** Failure to file a report required by the Commodity Exchange Act ("CEA" or the "Act")<sup>89</sup> and the regulations thereunder,<sup>90</sup> or the filing of a report with the Commodity Futures Trading Commission ("CFTC" or "Commission") that includes a false, misleading or fraudulent statement or omits material facts that are required to be reported therein or are necessary to make the report not misleading, may (a) constitute a violation of section 6(c)(2) of the Act (7 USC 9, 15), section 9(a)(3) of the Act (7 USC 13(a)(3)), and/or section 1001 of Title 18, Crimes and Criminal Procedure (18 USC 1001) and (b) result in punishment by fine or imprisonment, or both.

### PRIVACY ACT NOTICE

The Commission's authority for soliciting this information is granted in sections 4c(b) and 8 of the CEA and related regulations (see, e.g., 17 CFR § 32.3(b)). The information solicited from entities and individuals engaged in activities covered by the CEA is required to be provided to the CFTC, and failure to comply may result in the imposition of criminal or administrative sanctions (see, e.g., 7 U.S.C. §§ 9 and 13a-1, and/or 18 U.S.C. 1001). The information requested is most commonly used in the Commission's market and trade practice surveillance activities to provide information concerning the size and composition of the commodity derivatives markets. The requested information may be used by the Commission in the conduct of investigations and litigation and, in limited circumstances, may be made public on an aggregate basis in accordance with provisions of the CEA and other applicable laws. It may also be disclosed to other government agencies to meet responsibilities assigned to them by law. The information will be maintained in, and any additional disclosures will be made in accordance with, the CFTC System of Records Notices, available on [www.cftc.gov](http://www.cftc.gov).<sup>91</sup>

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<sup>88</sup> A trade option is generally a commodity option purchased by a commercial party that, upon exercise, results in the sale of a physical commodity for immediate (spot) or deferred (forward) shipment or delivery. See CFTC regulation 32.3(a) (17 CFR 32.3(a)) for more details. An unreported trade option is a trade option that is not required to be reported to a swap data repository by either counterparty pursuant to CFTC regulation 32.3(b)(1) and part 45 of the Commission's regulations (17 CFR 32.3(b)(1); 17 CFR part 45).

<sup>89</sup> 7 U.S.C. section 1, *et seq.*

<sup>90</sup> Unless otherwise noted, the rules and regulations referenced in this notice are found in chapter 1 of title 17 of the Code of Federal Regulations; 17 CFR Chapter 1 *et seq.*

<sup>91</sup> Note that, under the Paperwork Reduction Act, an agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number from the Office of Management and Budget.

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**GENERAL INSTRUCTIONS**

**Who Must File a Form TO** – 17 CFR § 32.3(b)(2) requires every counterparty to an unreported trade option to submit an annual filing to the Commission for the purpose of providing notice that it has entered into one or more unreported trade options in the prior calendar year. As noted above, an unreported trade option is a trade option that is not required to be reported to a swap data repository by either counterparty pursuant to CFTC regulation 32.3(b)(1) and part 45 of the Commission's regulations.

**When to file** – Form TO is an annual filing requirement due to the Commission no later than March 1 for the prior calendar year. For example, if a market participant enters into one or more unreported trade options between January 1, 2013 and December 31, 2013, the market participant must submit a completed Form TO to the Commission on or before March 1, 2014.

**Where to file** – Generally, Form TO should be submitted via the CFTC's web based Form TO submission process at <http://www.cftc.gov/>, or as otherwise instructed by the Commission or its designee. If submission through the web-based Form TO is impossible, the reporting counterparty shall contact the Commission at [techsupport@cftc.gov] or 202-418-5000 for further instructions.

**What to File** – All reporting counterparties filing a Form TO must complete all questions.

**Signature** – Each Form TO submitted to the Commission must be signed or otherwise authenticated by either (1) the reporting counterparty submitting the form or (2) an individual that is duly authorized by the reporting counterparty to provide the information and representations contained in the form.



**CFTC FORM TO****Name and Contact Information for Reporting Counterparty:**

## 1. Reporting Counterparty

Name and Address (including City, State, Country, Zip/Postal Code):

Reporting Counterparty website (if any):

Reporting Counterparty Unique Identifier (if any):

<input type="checkbox"/> Legal Entity Identifier "LEI" (if any)	
<input type="checkbox"/> National Futures Association ID Number (if any)	
<input type="checkbox"/> Other Party Identifier (Please Specify)	

2. Reporting Counterparty Contact Person<sup>92</sup>

Name and Job Title and/or Relationship with Reporting Counterparty:

Phone Number and Email Address:

**Commodity Category Indication:**

## 3. In the prior calendar year, the Reporting Counterparty entered into one or more unreported trade options in the following commodity categories:

Agricultural <sup>93</sup>	<input type="checkbox"/>	YES	<input type="checkbox"/>	NO
Metals <sup>94</sup>	<input type="checkbox"/>	YES	<input type="checkbox"/>	NO
Energy <sup>95</sup>	<input type="checkbox"/>	YES	<input type="checkbox"/>	NO
Other (Please Specify)	<input type="checkbox"/>	YES	<input type="checkbox"/>	NO

**Approximate Size of Unreported Trade Options Exercised in the Prior Calendar Year:**4. Please indicate, by commodity category, the approximate total value (quantity received/delivered multiplied by price paid/received) of physical commodities that the reporting counterparty purchased and/or delivered in connection with the exercise of unreported trade options in the prior calendar year:<sup>96</sup>

\_\_\_\_\_

<sup>92</sup> This should be an individual able to answer specific questions about the reporting counterparty's unreported trade options activity if contacted by Commission staff.

<sup>93</sup> Agricultural commodity is defined in the Commission's regulations at 17 CFR 1.3(z).

<sup>94</sup> Including, but not limited to, gold, silver, platinum, palladium, copper, aluminum, and rare earth metals.

<sup>95</sup> Including, but not limited to, petroleum products, natural gas, and electricity.

<sup>96</sup> For the purposes of answering this question, a reporting counterparty should not include the value of commodities that were the subject of trade options that remained open at the end of the prior calendar year or any trade options that expired unexercised during the prior calendar year.

5.

Agricultural	<input type="checkbox"/> None	<input type="checkbox"/> Under \$10M	<input type="checkbox"/> \$10M to \$100M	<input type="checkbox"/> Over \$100M
Metals	<input type="checkbox"/> None	<input type="checkbox"/> Under \$10M	<input type="checkbox"/> \$10M to \$100M	<input type="checkbox"/> Over \$100M
Energy	<input type="checkbox"/> None	<input type="checkbox"/> Under \$10M	<input type="checkbox"/> \$10M to \$100M	<input type="checkbox"/> Over \$100M
Other	<input type="checkbox"/> None	<input type="checkbox"/> Under \$10M	<input type="checkbox"/> \$10M to \$100M	<input type="checkbox"/> Over \$100M

**Signature/Authentication, Name, and Date**

☐ By checking this box and submitting this Form TO (or by clicking “submit,” “send,” or any other analogous transmission command if transmitting electronically), I certify that I am duly authorized by the reporting counterparty identified below to provide the information and representations submitted on this Form TO, and that the information and representations are true and correct.

Reporting Counterparty Authorized Representative (Name and Position):

\_\_\_\_\_ (Name)

\_\_\_\_\_ (Position)

Submitted on behalf of:

\_\_\_\_\_ (Reporting Counterparty)

Date of Submission:

\_\_\_\_\_

**BILLING CODE C**

**PART 33—REGULATION OF  
COMMODITY OPTION TRANSACTIONS  
THAT ARE OPTIONS ON CONTRACTS  
OF SALE OF A COMMODITY FOR  
FUTURE DELIVERY**

■ 4. The authority citation for part 33 continues to read as follows:

**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.

■ 5. Revise the part heading to read as set forth above.

■ 6. In § 33.2, revise paragraph (b) to read as follows:

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

\* \* \* \* \*

(b) The provisions of this part apply to commodity option transactions that are options on contracts of sale of a

commodity for future delivery except for commodity option transactions that are options on contracts of sale of a commodity for future delivery conducted or executed on or subject to the rules of a foreign board of trade.

\* \* \* \* \*

**§ 33.4 [Amended]**

■ 7. Amend § 33.4 as follows:

■ a. Remove the words “or for options on physicals in any commodity regulated under the Act,” in the introductory text;

■ b. Remove and reserve paragraphs (a)(4) and (a)(5)(iv);

■ c. Remove the phrase “or underlying physical” from paragraph (b)(1)(iii); and

■ d. Remove the phrase “, options on physicals,” from paragraph (d)(3).

■ 8. In § 33.7:

■ a. Amend paragraph (b) introductory text by revising the second paragraph of the Options Disclosure Statement;

■ b. Remove the phrase “or underlying physical commodity” wherever it appears in paragraph (b)(1) including its undesignated paragraphs;

■ c. Remove the phrase “(e.g., commitment to sell the physical)” from the fourth undesignated paragraph under paragraph (b)(1);

■ d. Revise the fifth undesignated paragraph under paragraph (b)(1);

■ e. Remove the phrase “or physical commodity” from paragraph (b)(2) introductory text and paragraph (b)(2)(i);

■ f. Remove the phrase “or underlying physical commodity” from paragraph (b)(5) both times it appears;

■ j. Revise the undesignated paragraph following paragraph (b)(5);

■ k. Remove the phrase “or underlying physical commodity” from paragraph (b)(6);

■ l. Remove the phrase “or the physical commodity” and the phrase “or underlying physical commodity” from paragraph (b)(7)(ii);

- m. Remove and reserve paragraph (b)(7)(iv); and
- o. Remove the phrase “or underlying physical commodity” from paragraphs (b)(7)(v) and (x).

The revisions read as follows:

§ 33.7 Disclosure.

\* \* \* \* \*

(b) \* \* \*

Options Disclosure Statement

\* \* \* \* \*

BOTH THE PURCHASER AND THE GRANTOR SHOULD KNOW THAT THE OPTION IF EXERCISED, RESULTS IN THE ESTABLISHMENT OF A FUTURES CONTRACT (AN “OPTION ON A FUTURES CONTRACT”).

\* \* \* \* \*

(1) \* \* \*

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.

\* \* \* \* \*

(5) \* \* \*

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.

\* \* \* \* \*

Issued in Washington, DC, on April 18, 2012, by the Commission.

David A. Stawick,  
*Secretary of the Commission.*

Appendices to Commodity Options  
Final Rule and Interim Final Rule—  
Commission Voting Summary and  
Statements of Commissioners

**Note:** The following appendices will not appear in the Code of Federal Regulations.

Appendix 1—Commission Voting  
Summary

On this matter, Chairman Gensler and Commissioners Sommers, Chilton, O’Malia,

and Wetjen voted in the affirmative; no commissioner voted in the negative.

Appendix 2—Statement of Chairman  
Gary Gensler

I support the final rules on Commodity Options. The Dodd-Frank Wall Street Reform and Consumer Protection Act includes commodity options within the statutory definition of “swap.” The final rule confirms that the same rules apply to commodity options as are applicable to other swaps, just as the law directs. In addition, the Commodity Futures Trading Commission will consider and seek comment on an interim final rule to provide a trade option exemption for certain commodity options that are physically delivered.

We received a lot of feedback from commercial market participants that commodity options used by commercial entities to deliver or receive physical commodities in connection with their business don’t need the same level of oversight as swaps. However, trade options will still be subject to position limits, appropriate reporting and recordkeeping requirements, and anti-fraud and anti-manipulation rules. The Commission is seeking additional comments on the trade option exemption, but the interim final rule makes the relief immediate.

[FR Doc. 2012–9888 Filed 4–26–12; 8:45 am]

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