



Commodity Futures Trading Commission

Office of Public Affairs

Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581
www.cftc.gov

CFTC Division of Market Oversight Responds to Frequently Asked Questions Regarding Commodity Options

Commodity Options FAQs¹

1. How are commodity options treated under the Commodity Exchange Act (“CEA” or “Act”), as amended by the Dodd-Frank Act?

Section 721 of the Dodd-Frank Act added new § 1a(47) to the CEA defining “swap” to include “[an] option of any kind that is for the purchase or sale, or based on the value, of 1 or more . . . commodities” In other words, all other things being equal, the general rule is that commodity options are to be regulated as swaps.²

2. Are there any exceptions to the requirement that commodity options must be regulated as swaps?

Yes. A commodity option involving a physical (as opposed to a financial) commodity may avoid being fully regulated as a swap if it is: (1) a commodity option embedded in a forward contract;³ (2) a volumetric commodity option embedded in a forward contract; or (3) a trade option.

1. A forward contract that contains an **embedded commodity option** may, nevertheless, be treated as an excluded forward (and not an option) if three conditions are met: (1) the option may be used to adjust the forward price, but does not undermine the overall nature of the contract as a forward; (2) the option does not target the delivery term, so that the predominant feature of the contract is actual delivery; and (3) the option cannot be severed and marketed separately from the overall forward in which it is embedded.⁴
2. An **embedded volumetric commodity option** is a specific type of option that can be used to hedge physical supply risk (as opposed to price risk) or to satisfy a regulatory requirement.⁵ Such options are often seen in contracts involving energy commodities. A typical volumetric option might provide flexibility as to delivery amounts in a contract that settles by physical delivery. A forward contract that contains an embedded volumetric commodity option may, nevertheless, be treated as an excluded forward (and not an option) if the optionality meets a seven-part test: (1) the embedded optionality does not undermine the overall nature of the contract as a forward; (2) the predominant feature of the contract is delivery; (3) the embedded optionality cannot be severed and marketed separately; (4) the seller intends to deliver the commodity if the option is exercised; (5) the buyer intends to take delivery if the option is exercised; (6) both parties are commercial parties; and (7) the exercise or non-exercise of the

¹ The Commission has prescribed rules (cited below) regarding commodity options and related subjects, such as the swap definition. This document contains Division of Market Oversight (“DMO”) staff interpretive responses to Frequently Asked Questions regarding those rules. The views expressed herein are solely the views of DMO staff and do not necessarily represent the views of any other Division, the Commission, or any Commissioner. To the extent some there is any inconsistency between the rules and this document, the rules govern.

² See 17 CFR § 32.2 and the Commodity Options Final and Interim Final Rules, 77 FR 25320 (Apr. 27, 2012) (“Commodity Options Rules”).

³ The CEA generally **excludes forward contracts from CFTC jurisdiction** (other than in cases of fraud or manipulation). A forward contract is “any sale of any cash commodity for deferred shipment or delivery.” See CEA § 1a(19).

⁴ See Product Definition Rules, 77 FR 48208, 48237 (Aug. 13, 2012).

⁵ In this context, a “regulatory requirement” includes “a supply contract entered into to satisfy a regulatory requirement that a supplier procure, or be able to provide upon demand, a specified volume of commodity (e.g., electricity).” See *id.* at 48238 n. 340.

embedded volumetric optionality is based primarily on physical factors or regulatory requirements that are outside the control of the parties.⁶

3. A **trade option** is a type of commodity option that, if it qualifies under the CFTC’s regulatory exemption criteria (see Question 3 below), is subject to lesser regulatory requirements than options that are regulated as swaps.

3. How does a commodity option qualify for the trade option exemption?

To qualify as a trade option, a commodity option must involve a physical commodity (i.e., an exempt or agricultural commodity) and meet three conditions: (1) the option is **offered by** either an “eligible contract participant” (generally speaking, a financially sophisticated entity)⁷ or a commercial participant (a producer, processor, commercial user of, or merchant handling, the underlying physical commodity); (2) the option is **offered to** a commercial participant; and (3) the option is 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.⁸

4. Are trade options generally excluded from regulation in the same manner as forward contracts?

No. While trade options are exempt from most of the rules applicable to swaps, they remain subject to certain, minimal regulatory requirements set out in CFTC regulations §§ 32.3 (b) – (d). In addition, the Division of Market Oversight has issued a staff no-action letter that provides relief from certain reporting and recordkeeping requirements of § 32.3(b).⁹

5. What are the recordkeeping requirements for trade options participants?

All trade option counterparties¹⁰ are required to comply with the recordkeeping requirements of Part 45 of the Commission’s regulations.¹¹

In the case of **Non-SD/MSPs**, the primary recordkeeping requirements are set out in § 45.2(b), which essentially requires keeping basic business records – i.e., “full, complete and systematic records, together with all pertinent data and memoranda, with respect to each swap in which they are a counterparty.”¹² Non-SD/MSPs also are subject to the other general recordkeeping requirements of § 45.2, such as the requirement that records must be maintained for 5 years¹³ and must be retrievable within 5 days.¹⁴

In the **Trade Option No-Action Letter**, DMO clarified that Non-SD/MSPs need to comply with only the recordkeeping requirements specifically set forth in § 45.2 of the Commission’s regulations for their trade options, subject to two conditions: (1) if the counterparty to the trade option is an SD/MSP, the Non-SD/MSP must obtain a legal entity identifier (“**LEI**”)¹⁵ pursuant to § 45.6 and provide such LEI to the SD/MSP counterparty; and (2) the Non-SD/MSP counterparty must notify DMO no later than 30 days after entering into trade options having an aggregate notional value in excess of \$1 billion during any calendar year.

⁶ See Product Definition Rules, 77 FR at 48238–40.

⁷ Eligible contract participant (“ECP”) is defined in § 1a(18) of the Act and was further defined in a joint rulemaking by the CFTC and SEC. See Further Definition of “Swap Dealer,” “Security-Based Swap Dealer,” “Major Swap Participant,” “Major Security-Based Swap Participant” and “Eligible Contract Participant”, 77 FR 30596 (May 23, 2012).

⁸ See 17 CFR § 32.3(a) and the Commodity Options Rules, 77 FR at 25326.

⁹ See CFTC Letter No. 13-08 (April 5, 2013) (“Trade Option No-Action Letter”), available at <http://www.cftc.gov/ucm/groups/public/@lrllettergeneral/documents/letter/13-08.pdf>.

¹⁰ The trade option rules generally apply to two classes of option participants / counterparties: (1) **swap dealers and major swap participants** (“**SD/MSPs**”), which are generally large and sophisticated entities that regularly engage in significant volumes of swap transactions; and (2) **Non-SD/MSPs** – all other (generally smaller) swap market participants, including end users. See CEA § 1a(49) (SD definition); CEA § 1a(33) (MSP definition); Participant Definition Final Rules, 77 FR 20128 (Apr. 3, 2012).

¹¹ See 17 CFR Part 45; 77 FR 2136 (Jan. 13, 2012) (“Swap Data Recordkeeping and Reporting Requirements”).

¹² 17 CFR § 45.2(b).

¹³ 17 CFR § 45.2(c).

¹⁴ 17 CFR § 45.2(e)(2).

¹⁵ See Questions 10 and 11 below for more information on LEIs.

SD/MSPs are subject to the same § 45.2 basic recordkeeping standards as Non-SD/MSPs, plus other requirements, including 17 CFR Part 23, subpart F, “Reporting, Recordkeeping, and **Daily Trading Records** for SD/MSPs, as detailed in § 45.2(a).”¹⁶

6. What are the reporting requirements for trade option participants?

Under § 32.3(b)(1), generally, counterparties are required to report trade options pursuant to the reporting requirements of Part 45¹⁷ if, during the previous 12 months, they have become obligated to report under Part 45 as the reporting counterparty in connection with any non-trade option swaps. In other words, if a counterparty is already reporting financial (or physical) swaps under Part 45 to a Swap Data Repository, it should report trade options to which it is a counterparty in the same way.

Under § 32.3(b)(2), trade options not otherwise required to be reported to an SDR under Part 45 are required to be reported by both counterparties to the transaction through an annual **Form TO** filing.¹⁸

However, the **Trade Option No-Action Letter** provides that, notwithstanding § 32.3(b)(1), **Non-SD/MSPs** are effectively exempt from ever having to report trade options pursuant to Part 45 provided that they: (1) comply with § 32.3(b)(2) by reporting all unreported trade options (i.e., those trade options in which both counterparties are Non-SD/MSPs) through an annual Form TO filing; and (2) notify DMO, through an email to Toreportingrelief@cftc.gov, no later than 30 days after entering into trade options having an aggregate notional value in excess of \$1 billion in any calendar year.¹⁹

DMO anticipates that the practical effect of § 32.3(b) and the Trade Option No-Action Letter is that trade options in which at least one counterparty is an SD/MSP will be reported by the reporting SD/MSP pursuant to Part 45, while trade options in which both counterparties are Non-SD/MSPs will be reported by both counterparties on Form TO.

7. What is Form TO?

Form TO, the “Annual Notice Filing for Counterparties to Unreported Trade Options,” is the form that Non-SD/MSPs may use to report their unreported trade option activity. It requires filers to report: basic identifying information about their firm (e.g., name, address, contact person); the commodity categories of their trade options (agricultural, metals, energy or other); and the approximate dollar value of the commodities they purchased or delivered in connection with the exercise of trade options during the previous calendar year, within broad ranges (under \$10 million, \$10 to \$100 million, and over \$100 million).

8. How and when do I file Form TO?

Form TO should be completed and submitted via the Commission’s web-based submission process (see the form for further details), available through the Commission’s website at <https://forms.cftc.gov/layouts/TradeOptions/TradeOptions.aspx>. The form must be filed no later than March 1 for the prior calendar year. Thus, the initial Form TO, for calendar year 2013, is due by March 1, 2014.

9. What is reported on Form TO: trade options entered into²⁰ or trade options exercised?

The filing requirement in § 32.3(b)(2) is triggered by **entering into** unreported trade options (i.e., trade options not already reported under Part 45)²¹ during the calendar year. Likewise, the “Commodity Category Indication” on the form requires reporting parties to check off the commodity categories of the options they “**entered into**.” However, the approximate dollar value chart on the form refers to the value of options **exercised**. Thus, a trade option counterparty should file the form only if unreported trade options were **entered into** during the calendar year, regardless of whether any trade options were exercised during that year.

¹⁶ See 17 CFR § 45.2(a)(4); 77 FR 20128 (Apr. 3, 2012) (Participant Definition Final Rules)

¹⁷ See 17 CFR Part 45; 77 FR 2136 (Jan. 13, 2012). See also 17 CFR § 32.3(c)(4); 17 CFR §§ 23.200-204.

¹⁸ See 17 CFR § 32.3(b)(2).

¹⁹ See Questions 12-15, 18 and 19 below regarding the \$1 billion threshold.

²⁰ In the context of Form TO, “entering into” an option is synonymous with “executing” an option.

²¹ See the answer to question 6, above re: reporting under Part 45.

For example, if, during 2013, a counterparty exercises trade options entered into during 2012 or earlier, but does not enter into any new trade options during 2013, that counterparty would have no obligation to file Form TO for 2013. If the counterparty does enter into trade options during 2013, the reporting requirement is triggered and the counterparty must file Form TO, reporting the approximate value of the commodities received or delivered in connection with trade options exercised during 2013 (whenever they may have been entered into).²²

Note that entering into trade options triggers the reporting requirement even if no options are exercised. Thus, for example, if during 2013 a counterparty entered into trade options, but did not receive or deliver any commodities in connection with the exercise of trade options, the obligation to file Form TO for 2013 still applies. In that case, the counterparty simply should indicate on Question 3 of the form the commodity categories of trade options it entered into during 2013, and on Question 4 of the form (“Approximate Size of Unreported Trade Options Exercised in the Prior Year”), check “none” on the approximate dollar value chart for each commodity category.

10. Form TO asks each reporting counterparty to provide a “Unique Identifier (if any).” First on the list of possible unique identifiers is a “Legal Entity Identifier” (“LEI”). What is an LEI?

An LEI is a unique identifier used to track counterparties to a swap transaction in all recordkeeping and reporting.²³

11. Do I need to get an LEI and, if so, how do I go about doing so?

Form TO does not require a reporting counterparty to obtain an LEI, only to list it if the party already has one. However, under the Trade Option No-Action Letter, in order to be exempt from any Part 45 recordkeeping rules other than those contained in § 45.2, a Non-SD/MSP that enters a trade option with an SD/MSP must obtain an LEI and provide it to the SD/MSP. Without getting an LEI from its Non-SD/MSP counterparty, the SD/MSP would not be able to comply with its own Part 23 and Part 45 recordkeeping and reporting requirements.

The Commission’s Division of Market Oversight, in conjunction with the CFTC Office of Data and Technology, has issued an Advisory which explains how to obtain an LEI.

See: http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/dmo_odtadvisory.pdf.

12. Which transactions should be counted for purposes of the \$1 billion “aggregate notional value” reporting requirement in the Trade Option No-Action Letter?

All trade options entered into during the course of a given calendar year—regardless of whether reported by an SD/MSP pursuant to Part 45 or through Form TO, and regardless of the value of trade options that are exercised—should be counted towards the \$1 billion aggregate notional threshold.²⁴ See questions 13 and 14 below regarding reporting for 2013.

13. Should the reporting obligation for the first Form TO filing, for calendar year 2013, be triggered by trade options entered into beginning January 1, 2013, or only those trade options entered into on or after April 10, 2013?

The first Form TO filing, covering calendar year 2013, should include all unreported trade options entered into **on or after April 10, 2013**. The Interim Final Rule portion of the Commodity Options Rules exempted trade options from all requirements of the CEA and the Commission’s regulations, except for certain enumerated provisions. While the Interim Final Rule explicitly requires trade options to be reported under either Part 45 or Form TO, the Commission did not contemplate requiring market participants to report historical trade options under Part 46. Subsequent to the Interim Final

²² However, see Question 13 below, which notes that the requirement to make the first possible Form TO filing, for calendar year 2013, would only be triggered by trade options entered into on or after April 10, 2013.

²³ See 17 CFR § 45.6; Swap Data Recordkeeping and Reporting Requirements, 77 FR 2136 (Jan. 13, 2012).

²⁴ See footnote 20 of the Trade Option No-Action Letter (CFTC Letter No. 13-08) for further discussion of how to calculate the aggregate notional value of options entered into for purposes of the \$1 billion threshold condition.

Rule becoming effective, April 10, 2013 was established as the general reporting compliance deadline for all Non-SD/MSPs.²⁵ Therefore, any trade options entered into prior to April 10, 2013 would be considered historical and thus (since Part 46 does not apply to trade options) not subject to reporting under the Interim Final Rules.²⁶

14. Should the initial \$1 billion "aggregate notional value" calculation cover all of 2013, or only trade options entered into on or after April 10, 2013?

For the same reasons set out in answer 13 above, for calendar year 2013 (and 2013 only) calculation of the \$1 billion aggregate notional value begins with trade options entered into on or after April 10, 2013.

15. What does the CFTC do with the information filed on Form TO, or the information that a person has entered into trade options over the \$1 billion threshold?

As noted in the preamble to the Commodity Options Rules, the information filed on Form TO will

... provide the Commission [with] 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 [see 17 CFR §§ 1.31(a)(2) and 45.2(h)] 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.²⁷

The information regarding the \$1 billion threshold serves essentially the same purpose.

16. How do trade options participants comply with § 32.3(c)(2), regarding position limits?

Under the Commodity Options Rules, trade options are subject to the Part 151 position limit requirements. Part 151, however, has been vacated by a court decision, meaning that trade options currently are not subject to any position limits.²⁸ Staff notes that trade options may become subject to position limits in future rulemakings.²⁹

17. How do I measure the amount of physical commodities purchased or sold through forward contracts with embedded volumetric options for purposes of both the \$1 billion aggregate notional value threshold and the size of options exercised, as reported on Form TO? Also, for purposes of the \$1 billion threshold and Form TO, how do I calculate the gross notional value of an open-ended option – i.e., one with no maximum deliverable amount?

To the extent a transaction includes both a fixed amount that must be delivered or received and an embedded volumetric option³⁰ to make or take delivery of an additional amount, the fixed amount does not count toward calculating the \$1 billion threshold and is not reportable on Form TO. Only the amount of commodity subject to the option should be considered for purposes of calculating the \$1 billion threshold and reporting on Form TO.

²⁵ See 77 FR 2136, at 2195 (establishing the date prior to which Non-SD/MSP swaps in all asset classes would be considered historical). DMO notes that the preamble to the Trade Option Interim Final Rule explaining the reporting timeframe for Form TO was written before the reporting compliance deadlines had been set. See 77 FR 25329 (stating that Form TO for calendar year 2013 should cover all unreported trade options entered into beginning on January 1, 2013).

²⁶ Likewise, if a trade option that was entered into prior to April 10, 2013 is exercised on or after April 10, 2013, that exercise would not be subject to reporting under the Interim Final Rules or any other rule.

²⁷ 77 FR 25320 at 25328.

²⁸ See *Int'l Swaps and Derivatives Ass'n v. Commodity Futures Trading Comm'n*, Civil Action No. 11-cv-2146 (RLW), 2012 U.S. Dist. LEXIS 139788 (D.D.C. Sept. 28, 2012). The case is currently being appealed by the Commission, meaning that Part 151 potentially could be reinstated and thus would apply to trade options, absent further revisions to the Commission's regulations during the interim.

²⁹ Note, however, that the preamble to the Commodity Options Rules points out 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 limits." 77 FR 25328, n.50.

³⁰ See question 2 above regarding embedded volumetric options.

In calculating the gross notional value of an open-ended option with no maximum amount, calculate the amount by using “the maximum volume of the commodities that could be bought or sold.”³¹ The maximum volume/amount that could be bought or sold pursuant to an open-ended option would be the maximum amount that could be used (e.g., the difference between the baseload amount and historical maximum amount used over the same period). To calculate the fair market value of the maximum amount, if there is no fixed price stated in the option, but rather a reference price (e.g., the settlement price of a NYMEX futures contract that expires in six months), use the current price of the referenced contract (e.g., the current price of the NYMEX futures contract).³²

18. What are the Form TO reporting obligations for a non-US non-SD/MSP counterparty with respect to its commodity trade option transactions with US non-SD/MSP counterparties? Is the non-US person required to: (1) file the annual Form TO if its US counterparties also utilize the Form TO in lieu of SDR reporting; and (2) calculate the \$1 billion gross notional value threshold for purposes of relying on No-Action Letter 13-08?

In general, yes. The Commission recently issued its Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations.³³ This Cross Border Guidance discusses the Commission’s general policy on applying the CEA’s swaps provisions to a non-US non-SD/MSP that enters into swaps with a counterparty that is also a non-SD/MSP. The Cross Border Guidance says that for a swap between a non-US non-SD/MSP and a US non-SD/MSP, the parties generally would be expected to comply with the applicable CEA swaps provisions.³⁴ On the other hand, a swap between two non-US non-SD/MSPs would generally not be subject to the CEA swaps provisions.³⁵

Thus, in general, a non-US non-SD/MSP counterparty should file the annual Form TO if its trade options with US counterparties are not reported to an SDR, and such filing should reflect only its trade options with US counterparties. In addition, a non-US non-SD/MSP counterparty should generally calculate the \$1 billion gross notional value threshold for purposes of relying on No-Action Letter 13-08 by reference to its trade options with US counterparties.

³¹ See note 20 of No-Action Letter 13-08.

³² Again, see note 20 of No-Action Letter 13-08 for more details.

³³ See 78 FR 45292 (July 26, 2013) (“Cross Border Guidance”).

³⁴ See *id.* at 45361. The Cross Border Guidance also sets out the Commission’s interpretation of the term “US person” (and, conversely, “non-US person”), see *id.* at 45308, which the Commission expects to apply in determining who is a US person or non-US person for purposes relating to commodity options.

³⁵ See *id.* at 45363. However, the CEA swaps provisions may apply if both of the non-US non-SD/MSPs are guaranteed or conduit affiliates, as discussed more fully in the Cross Border Guidance. See *id.* at 45364.