

Client Alert

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CFTC Proposes Relief from Trade Option Reporting and Recordkeeping Requirements for Commercial End Users

By **Julian E. Hammar**

On April 30, 2015, the Commodity Futures Trading Commission (“CFTC”) approved for publication in the Federal Register proposed amendments to the trade option exemption (the “Proposal”) that would reduce reporting and recordkeeping requirements for trade option counterparties that are not swap dealers or major swap participants (“Non-SD/MSPs”). Notably, the Proposal would eliminate the annual Form TO filing requirement for Non-SD/MSPs in connection with their trade options, while requiring them to notify the CFTC’s Division of Market Oversight (“DMO”) if their trade options have, or are expected to have, an aggregate notional value in excess of \$1 billion in any calendar year. The Proposal will be available for public comment for 30 days after its forthcoming publication in the Federal Register. The Proposal is available [here](#).

BACKGROUND

The Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”) amended the Commodity Exchange Act (“CEA”) to include a definition of the term “swap,” which includes commodity options, whether physically or financially settled. Commodity options that qualify for the trade option exemption are exempt from most requirements applicable to swaps under Dodd-Frank. Under current CFTC rules that the Proposal would not modify, to qualify for the trade option exemption, a commodity option must involve a nonfinancial commodity (*i.e.*, an exempt or agricultural commodity) and must be:

- offered by either an “eligible contract participant” as defined in the CEA (generally, a financially sophisticated entity) or a producer, processor, commercial user of, or merchant handling the underlying physical commodity;
- offered to a producer, processor, commercial user of, or merchant handling the underlying physical commodity; and
- 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.

Under existing CFTC regulations that the CFTC now proposes to modify, trade options that meet these conditions must be reported to a swap data repository in accordance with Part 45 of the CFTC’s regulations, if, during the 12 months prior to the trade option being entered into, one of the counterparties has been obligated to report a non-trade option swap under Part 45. If neither counterparty has had to report non-trade option swaps under Part 45 during that period, then both counterparties may report their trade option transactions annually on the CFTC’s

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Form TO. Eligibility to use Form TO was extended pursuant to a CFTC staff no-action letter issued in April 2013. Under the no-action letter, if one of the parties is required to report non-trade option swaps under Part 45 during the 12-month period (and thus cannot use Form TO under the rule), and that party is a non-SD/MSP, then it may use Form TO, provided that it notifies DMO by email no later than 30 days after entering into trade options having an aggregate notional value in excess of \$1 billion in any calendar year. Trade options are also subject to requirements in addition to reporting under Part 45, including, among others, recordkeeping, swaps large trader reporting, and position limits, as well as anti-fraud and anti-manipulation provisions.

THE PROPOSAL

The CFTC's Proposal would eliminate the Part 45 reporting requirement for Non-SD/MSPs in connection with trade options. In addition, the CFTC proposes to eliminate the Form TO annual notice reporting requirement applicable to Non-SD/MSPs for trade options not reported under Part 45. Instead, under CFTC Reg. 32.3 as proposed to be amended, a Non-SD/MSP would only need to provide email notice to DMO within 30 days after entering into trade options (whether reported or unreported) that have an aggregate notional value in excess of \$1 billion in any calendar year. In the alternative, a Non-SD/MSP could provide notice by email to DMO that it reasonably expects to enter into trade options (whether reported or unreported) having an aggregate notional value in excess of \$1 billion during any calendar year.

In its release explaining the proposed new rules, the CFTC states that, while there may be surveillance benefits from Form TO data, completing Form TO imposes costs that may be significant for Non-SD/MSPs, particularly small commercial end users. Moreover, the CFTC observes that Non-SD/MSPs would remain subject to recordkeeping requirements under Part 45, which require market participants to maintain full and complete records and to open their records to CFTC inspection upon request, so that the CFTC would remain able to collect information regarding trade options as necessary. The proposed email notice requirement for trade options in excess of \$1 billion is intended to give the CFTC insight into the market for unreported trade options and the identities of the largest trade option market participants.

Although the Proposal would require a Non-SD/MSP to comply with the applicable recordkeeping requirements of Part 45 in connection with their trade options, including the requirement to obtain a legal entity identifier ("LEI") pursuant to CFTC Reg. 45.6 and provide such LEI to its counterparty that is an SD/MSP, a Non-SD/MSP would not be required to meet the requirements of CFTC Regs. 45.5 and 45.7 regarding use of unique swap identifiers and unique product identifiers, respectively.

The Proposal also would eliminate for now, at least, the requirement that trade options be subject to position limits, which the CFTC states should be addressed in the position limits proposed rulemaking currently under consideration.

If adopted, the CFTC's Proposal will provide welcome relief for many Non-SD/MSP commercial end users with respect to their physically settled trade options.

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