

Client Alert

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

By **Julian E. Hammar**

On March 16, 2016, the U.S. Commodity Futures Trading Commission (“CFTC”) approved a final rule that eliminates the reporting and recordkeeping requirements in current CFTC regulations for trade option counterparties that are neither swap dealers nor major swap participants (“Non-SD/MSPs”), including commercial end users that transact trade options in connection with their businesses. Significantly, the final rule eliminates the requirement that such counterparties annually file a Form TO in connection with their trade options, and does not require them, as had been proposed, to notify the CFTC’s Division of Market Oversight (“DMO”) if they enter into trade options that have, or are expected to have, an aggregate notional value in excess of \$1 billion in any calendar year. The final rule is effective upon publication in the Federal Register, which occurred on March 21, 2016. The final rule is available [here](#).

Background

Commodity options, whether physically or financially settled, are included within the definition of the term “swap” as added by the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”) to the Commodity Exchange Act (“CEA”). However, commodity options that qualify for the trade option exemption are exempt from most requirements applicable to swaps under Dodd-Frank. 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, or commercial user of, or merchant handling, the underlying physical commodity;
- Offered to a producer, processor, or 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.

Previously under the CFTC’s regulations that the final rule modifies, trade options were required to be reported to a swap data repository if, during the 12 months prior to the trade options being entered into, one of the counterparties was obligated to report a non-trade option swap under Part 45 of the CFTC’s regulations. If neither counterparty was required to report non-trade option swaps under Part 45 during that period, then both parties could report their trade options annually on the CFTC’s Form TO. Eligibility to use this form was extended by a

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CFTC staff no-action letter to all Non-SD/MSPs irrespective of whether one of the parties was required to report non-trade option swaps, but the CFTC's no-action relief required that, if a Non-SD/MSP had to report non-trade option swaps, it was required to notify 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.

In addition to these requirements, Non-SD/MSP trade options were subject to swaps recordkeeping, swaps large trader reporting, and position limits, as well as anti-fraud and anti-manipulation provisions.

In April 2015, the CFTC proposed to modify these rules by eliminating the Part 45 reporting requirement for Non-SD/MSPs in connection with trade options and by eliminating the requirement that Non-SD/MSPs file Form TO. Under the proposed rule, a Non-SD/MSP would have been required to provide email notice to DMO within 30 days after entering into trade options (whether reported or unreported) if such options had an aggregate notional value in excess of \$1 billion in any calendar year, or the Non-SD/MSP reasonably expected to enter into trade options in excess of \$1 billion during any calendar year. Under the proposed rule, swaps recordkeeping requirements would also have continued to apply to trade options entered into by Non-SD/MSPs, with certain exceptions. For more information on the proposed rule, see our client alert [here](#).

Final Rule

Under the final rule, Non-SD/MSPs will not be subject to Part 45 reporting requirements in connection with their trade options. In addition, the final rule eliminates the Form TO annual reporting requirement and the Form TO altogether. The CFTC in the final rule also declined to impose the proposed requirement that a Non-SD/MSP provide notice to the CFTC of its trade option activities if such activities had a value of more than \$1 billion in any calendar year. The CFTC acknowledged that these reporting and notice requirements provided limited surveillance and regulatory oversight benefits, while imposing significant costs on commercial end users that are required to classify, value, and track their trade options.

Further, the final rule eliminates swap-related recordkeeping requirements for Non-SD/MSPs in connection with their trade option transactions, which would have been required under the proposed rule. However, the final rule does require a Non-SD/MSP, if it enters into a trade option with a counterparty that is an SD/MSP, to obtain a legal entity identifier and provide it to the SD/MSP counterparty. The final rule also eliminates the reference to the vacated Part 151 position limits requirements in the trade option exemption regulation and, in the preamble to the final rule, the CFTC states that federal speculative position limits should not apply to trade options, which will be addressed in the proposed rulemaking on position limits, if it is adopted.

The final rule does not alter the applicability of the large swaps trade reporting rules to trade options, and trade options remain subject to the CFTC's anti-fraud and anti-manipulation authorities. Requirements applicable to swap dealers entering into trade options, including certain business conduct standards, recordkeeping, swaps reporting, capital, and margin remain the same.

The final rule provides welcome relief to many commercial end users that no longer will need to identify and separately track their trade options and report them on Form TO or file a notice with DMO. Such end users will also not have to comply with swaps recordkeeping requirements, but must only maintain records of trade options

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“in the ordinary course of business,” although they will be required to provide a legal entity identifier to an SD/MSP. The CFTC’s expressed intention not to impose position limits on trade options will likely also be welcomed by market participants.

Contact:

Julian E. Hammar

(202) 887-1679

jhammar@mofo.com

James Schwartz

(212) 336-4327

jschwartz@mofo.com

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