CFTC ADOPTS FINAL TRADE OPTION RULE

On March 16, 2016, the Commodity Futures Trading Commission ("**CFTC**") unanimously approved amendments to the rules applicable to certain physically-settled options referred to as "trade options." This final rule substantially reduces the regulatory burdens for end-users entering into trade options by eliminating reporting and recordkeeping requirements. The CFTC also confirmed that it does not intend to impose position limits on trade options. The final rule becomes effective upon publication in the Federal Register, which we expect to occur later this week or early next week.[1]

Trade Option Background

Although the CFTC interprets the definition of "swap" under the Commodity Exchange Act ("**CEA**") to include physically-settled options, in 2012 the CFTC adopted interim-final rule 32.3, which established an exemption for physically-settled options that meet certain criteria.[2] The 2012 interim-final rule exempted trade options from all provisions of the CEA applicable to swaps, other than those specifically listed in CFTC Rule 32.3(c). In 2013, CFTC Staff issued No-Action Letter 13-08 refining the list of rules applicable to trade options in CFTC Rule 32.3(c).[3]

Final Rule Amending Rules Applicable to Trade Options

The final rule unanimously approved by the CFTC on March 16, 2016 significantly reduces the number of rules applicable to trade options under CFTC Rule 32.3(c). Below is a summary of the key aspects to the final rule:

- **Trade Options Will Not be Subject to Position Limits**. The CFTC eliminated the requirement that trade options are subject to position limits. The CFTC noted that it plans to address its proposed rule to establish position limits on futures and swaps and confirm that trade options are not subject to position limits.[4]

- **CFTC Eliminated Form TO**. The CFTC eliminated the requirement for end-users to file an annual "Form TO" summarizing an end-user's trade option activity for the prior calendar year. Many market participants urged the CFTC to remove the Form TO due to the significant costs associated with compiling the data necessary to complete Form TO. In the final rule, the CFTC acknowledged the significant costs imposed and the "limited surveillance and regulatory benefit."[5]

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1 A copy of the current final rule prior to publication in the federal register can be found here: http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/federalregister031616b.pdf

2 *See Commodity Options*, 77 Fed. Reg. 25320 (Apr. 27, 2012).

3 *See* CFTC Letter No. 13-08 (Apr. 5, 2013).

4 *See Position Limits for Derivatives*, 78 Fed. Reg. 75680 (Dec. 12, 2013).

5 *See* Page 14 of the final rule.

- **End-Users Are Not Required to Comply with Swap Recordkeeping Requirements for Trade Options.** The CFTC eliminated the requirement for end-users to maintain records of trade options in accordance with the swap recordkeeping requirements described in Part 45 of the Commission's regulations. The Commission expects end-users to maintain records of trade options "in the ordinary course of business."[6] However, if an end-user enters into a trade option with a swap dealer or major swap participant, the end-user must obtain a legal entity identifier ("**LEI**") and provide the LEI to its counterparty.

- **End-Users Are Not Required to Submit $1 Billion Notice Filing**. Pursuant to No-Action letter 13-08, CFTC Staff expected that a market participant file an email notice to the Division of Market Oversight ("**DMO**") if the participant entered into trade options in a given calendar year with a total notional value in excess of $1 billion. Although the CFTC proposed to codify this requirement in the CFTC Rule 32.3(c), the final rule does not include the notice filing requirement. In the final rule, the CFTC acknowledged that the relief provided by eliminating the Form TO and recordkeeping requirements "would be more meaningful if [non-swap dealer and non-major swap participant] counterparties are not required to classify, value, and track their trade options for the exclusive purpose of complying with the proposed Notice Requirement."[7]

- **Trade Option Rules for Swap Dealers Remain the Same**. Compared to the 2012 interim-final rule, the rules applicable a swap dealer's trade option activity remains unchanged. Swap dealers must still comply with: internal business conduct standards, recordkeeping, reporting, capital, and margin.

- **Swaps Large Trade Reporting Rules Continue to Apply to Trade Options**. Where a swap dealer or clearing member enters into or clears a trade option that is subject to the CFTC's Part 20 swaps large trader reporting rule, the swap dealer or clearing member must report the trade option to the CFTC. This rule is consistent with the 2012 interim-final rule.

- **Trade Options Remain Subject to the CFTC's anti-fraud and anti-manipulation authority**.

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If you have any questions about the final rule, please contact Paul Pantano (paul.pantano@cwt.com), Athena Eastwood (athena.eastwood@cwt.com), or Neal Kumar (neal.kumar@cwt.com).

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6 *See* Page 19 of the final rule.

7 *See* Page 14 of the final rule.