

June 6, 2011

**By Electronic Submission**

David A. Stawick  
Secretary  
Commodity Futures Trading Commission  
1155 21st Street, N.W.  
Washington, DC 20581

**Re: Transition Exemption For Options on Agricultural Commodities  
Entered Into After July 15, 2011**

Dear Mr. Stawick:

We submit this request to the Commodity Futures Trading Commission (“CFTC” or “Commission”) on behalf of our clients, the Commodity Options and Agricultural Swaps Working Group (the “Working Group”). The Working Group previously has submitted comment letters addressing the CFTC’s proposed rules regarding commodity options and agricultural swaps, including the proposed definition of agricultural commodity.<sup>1</sup> The Working Group is comprised of an agribusiness trade association, diversified financial institutions, and commercial companies that provide risk management contracts, including agricultural and other commodity options and swaps, to producers, processors, merchants handling, and users of physical commodities, or that use such contracts to hedge their commercial risk.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) is a very complex statute that, if not implemented with great care, has the potential to have significant adverse consequences on the physical and financial commodity markets that are critical to the US economy.<sup>2</sup> In order to avoid disruption in the wholesale commodity markets, the Working Group respectfully submits that the Commission should take action now to ensure that there are no unintended interruptions in the ability of market participants to continue to enter into important merchandising and risk management transactions.

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<sup>1</sup> See the Working Group’s comments filed in response to the CFTC’s Advance Notice of Proposed Rulemaking and Request for Comment (the “Advance Notice”) regarding treatment of swaps in an agricultural commodity (Agricultural Swaps, 75 Fed. Reg. 59666 (Sept. 28, 2010)); the CFTC’s Notice of Proposed Rulemaking regarding the definition of “agricultural commodity” (Agricultural Commodity Definition, 75 Fed. Reg. 65586 (Oct. 26, 2010)); and the CFTC’s February 3, 2011 Notice of Proposed Rulemaking Regarding Agricultural Commodity Swaps and Commodity Options (Commodity Options and Agricultural Swaps Proposed Rule, 76 Fed. Reg. 6095 (Feb. 3, 2011)).

<sup>2</sup> Pub. L. No. 111-203 (2010) (to be codified as an amendment to the Commodity Exchange Act (“CEA”) in 7 U.S.C. ch.1).

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Many provisions of the Dodd-Frank Act, other than those that already are in effect or that require implementing regulations, become effective on July 16, 2011. Section 723(c)(3) of the Dodd-Frank Act, which appears to take effect on July 16, prohibits market participants from entering into swaps based on an “agricultural commodity” as defined by the CFTC, except pursuant to an exemption or rules issued by the Commission under Section 4(c) of the CEA, as amended.<sup>3</sup> Because the swap exemption in Part 35 of the Commission’s regulations was issued pursuant to Section 4(c), swaps based on agricultural commodities will continue to be permitted after July 15<sup>th</sup> subject to the conditions set forth therein. However, the new definition of “swap” in the Dodd-Frank Act also includes options.<sup>4</sup> The Commission previously has stated that options on enumerated agricultural commodities cannot be entered into pursuant to Part 35. Indeed, when the Commission issued the Final Rule implementing Part 32.13 of its regulations, it announced that “[a]ny off-exchange option on an enumerated agricultural commodity must comply with Commission Rule 32.13(g) for exemption from the Act and Commission rules, and *no other exemptive provision is available.*”<sup>5</sup>

Although the prohibition in Section 723(c)(3) of the Dodd-Frank Act only applies to agricultural commodities, the Working Group wants to ensure that market participants can continue to enter into options on any type of commodity after July 15, 2011. Congress and the Commission historically have distinguished between the regulatory treatment of transactions involving “enumerated” and non-enumerated agricultural commodities, and other physical or “exempt” commodities. For example, options on non-enumerated agricultural and other commodities currently may be entered into pursuant to Regulation 32.4, and other CEA

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<sup>3</sup> Section 723(c)(3)(A) of the Dodd-Frank Act prohibits “the execution of, any swap in an agricultural commodity (as defined by the Commodity Futures Trading Commission)” except those entered into pursuant to a rule issued by the CFTC pursuant to its Section 4(c) exemptive authority (emphasis added). Arguably, the prohibition in 723(c)(3)(a) is not self-executing, but rather, requires the Commission to define the term “agricultural commodity” before it becomes effective. However, the Commission’s proposed Commodity Options and Agricultural Swaps Proposed Rule does not indicate that the Commission believes that it must define agricultural commodity before the prohibition in Section 723(c)(3)(A) takes effect. Because Part 32 remains in effect until expressly repealed by the CFTC, if the Commission agrees that the prohibition in Section 723(c)(3)(a) is not self-executing, it would appear that market participants could continue to transact in options on all types of agricultural commodities until the Commission’s Commodity Options and Agricultural Swaps Proposed Rule is final.

<sup>4</sup> Although the Working Group believes that options that are intended to be physically settled upon exercise (“Physical Commodity Options”) should be regulated as a third category of transaction separate from swaps and futures, until the CFTC issues its final rules, the application of Section 723(c)(3) to commodity options remains uncertain. See Comment Letter dated January 12, 2011 of the Working Group filed in response to the Commodity Options and Agricultural Swaps Proposed Rule.

<sup>5</sup> See Final Rule, 63 Fed. Reg. 18821 at 18826 (Apr. 16, 1998) (emphasis added).

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exemptions and CFTC regulations.<sup>6</sup> However, under the Commission's current regulatory framework, options on enumerated agricultural commodities only may be entered into pursuant to Part 32.13(g) of the regulations. Unlike Part 35, Part 32 (including the agricultural trade option exemption), was issued pursuant to CEA 4c(b). The Commission indicated in the Commodity Options and Agricultural Swaps Proposed Rule that market participants will not be able to transact in options on agricultural commodities pursuant to Part 32 after July 15, 2011, when Section 723(c)(3) becomes effective.<sup>7</sup> Consequently, unless the Commission acts now, market participants will not be able to enter into options on agricultural commodities between July 16, 2011, and whenever the Commission issues its final Commodity Options rule.

We understand that the Commission is considering several different solutions to ensure that the challenges of implementing a new and complex regulatory regime do not interfere with ongoing commerce in the commodity markets. The Working Group requests that the Commission issue an interim final rule or order amending its Part 35 exemption, subject to public comment but effective immediately, that would: (a) specifically allow market participants to transact in all commodity options, including options on enumerated agricultural commodities, subject to those terms and conditions that the Commission determines are appropriate;<sup>8</sup> (b) amend the definition of Eligible Swap Participant ("ESP") to comport with the definition of Eligible Contract Participant ("ECP"); and (c) replace Part 35.2(d) (which references multilateral transaction execution facilities) with a provision that expressly allows the trading of agricultural commodity swaps and commodity options on exempt commercial markets, designated contract markets ("DCMs") and swap execution facilities (to the extent that the SEF rules are finalized before the rules regarding agricultural swaps) ("Transition Exemption"). This would subject agricultural swaps and commodity options to the same conditions applicable to other commodity swaps.

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<sup>6</sup> For example, until July 16<sup>th</sup>, some options on other commodities may be transacted under CEA sections 2(d), 2(g) and 2(h) of the CEA and Part 35 of the Commission's regulations. Moreover, when the Commission issued the Final Rule implementing Regulation 32.4, it did not state, as it did when it issued Regulation 32.13(g), that no exemptive provision other than Commission rule 32.4 is available for off-exchange options on a non-enumerated agricultural commodity or any other commodity. In fact, the Part 35 regulations were issued pursuant to the Commission's authority, not only under CEA 4(c), but also under CEA 4c(b) ("In enacting this exemptive rule, the Commission is 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."). See Part 35 Final Rule, 58 Fed. Reg. 5587, 5589 (1993).

<sup>7</sup> Commodity Options and Agricultural Swaps Proposed Rule, 76 Fed. Reg. 6095 (Feb. 3, 2011).

<sup>8</sup> While this request is focused on agricultural commodity options, the Working Group requests that an interim final rule or order amending its Part 35 exemption provide comparable treatment for all types of commodity options.

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The Transition Exemption would satisfy the statutory requirements for an exemption under Section 4(c) of the CEA, which authorizes the Commission to exempt an agreement, contract or transaction from particular requirements of the CEA if it determines that:

- the exemption is consistent with the public interest and the purposes of the CEA;
- the agreement, contract or transaction will be entered into between “appropriate persons;” and
- the agreement, contract or transaction will not have a material adverse effect on the ability of the Commission or any DCM to discharge its duties under the CEA.<sup>9</sup>

The Transition Exemption is consistent with the public interest because it will provide legal certainty for market participants to continue to transact in OTC options on agricultural commodities subject to the same conditions applicable to other commodity options and swaps until the Commission finalizes its Commodity Option and Agricultural Swaps Proposed Rule. Under the Transition Exemption, only appropriate persons could enter into options on commodities, including enumerated agricultural commodities, because both parties must be ESPs, as amended to conform to the definition of ECP. Moreover, the Transition Exemption will not have a material adverse effect on the ability of the Commission or any DCM to discharge its duties under the CEA for the same reasons applicable to existing Part 35, including the Commission’s reservation of its anti-fraud and anti-manipulation authority over such transactions.

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<sup>9</sup> The Commission effectively has already made these findings when it issued the Part 35 swap exemption, as well as the trade option rule in Part 32.13 (Final Rule, 63 Fed. Reg. 18821 at 18823) (in which the Commission stated “[f]or this reason, the Commission believes that the public interest will best be served by making agricultural trade options available to the market now under the regulatory structure as proposed and by consideration of possible amendment of the interim rules based upon actual market experience”) and, preliminarily, when it proposed to treat agricultural swaps and options like all other swaps in its Commodity Options and Agricultural Swaps Proposed Rule, 76 Fed. Reg. 6095 at 6103-04 (Feb. 3, 2011) (“Reducing systemic risk and increasing innovation and competition by permitting agricultural swaps to trade under the same terms and conditions as other swaps would be consistent with the purposes listed above, the general purposes of the CEA, and the public interest”).

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Please contact us if you have any questions about the Working Group's request.

Respectfully submitted,



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Athena Eastwood

## Commodity Options and Agricultural Swaps Working Group

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Citigroup  
Commodity Markets Council  
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Gavilon, LLC  
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INTL FCStone Inc.  
JPMorgan Chase & Co.  
Morgan Stanley  
Wells Fargo & Co.

cc: Honorable Gary Gensler, Chairman  
Honorable Michael Dunn, Commissioner  
Honorable Jill E. Sommers, Commissioner  
Honorable Bart Chilton, Commissioner  
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