

has been particularly cautious due to the history of abuses which had been associated with such transactions.<sup>3</sup>

Unsatisfactory experiences with what essentially were unregulated sales of options on commodities in the early 1970's, and further abuses under interim regulations adopted in 1976 ultimately resulted in the Commission's suspension of the offer and sale of all commodity options as of June 1, 1978 and the codification of that suspension by Congress in the Commodity Exchange Act of 1978. See 46 FR 54500, 54502 (November 3, 1981). The suspension codified by Congress permitted the Commission to introduce option trading, but only if the Commission could document to its Congressional oversight committee its ability to regulate successfully such transactions.<sup>4</sup>

Mindful of this history, in proposing a pilot program for the offer and sale of options in 1981, the Commission expressly stated that it was:<sup>5</sup>

Cognizant of the need to exercise a strong degree of control over all aspects of commodity option trading.

Thus, the final domestic exchange-traded commodity option rules adopted in 1981 authorized the introduction of options under a limited pilot program which permitted only one option contract per exchange, did not permit either foreign options or options on physical commodities to be offered, and placed significantly greater self-regulatory responsibilities on boards of trade than was then required for futures trading, particularly with respect to the protection of the public from sales practice abuses.<sup>6</sup>

#### Evolution of Domestic Option Regulations

Although starting narrowly and cautiously, the Commission's options regulations have evolved consistently with the acquisition of an operational history under those regulations. Thus, in December 1982 the Commission expanded the pilot program to permit each exchange to trade one option on a futures contract and one option contract

<sup>3</sup> The Commission notes that the abuses which characterized the offer and sale of commodity options in the past generally involved sales practices, 46 FR 54500, 54503 (November 3, 1981), including sales activity with respect to alleged "London options" (which appeared to have been perpetrated exclusively by sales persons or organizations in the United States, and did not involve any improper activities on the part of foreign exchanges), see 42 FR 18246, 18249 (April 5, 1977).

<sup>4</sup> See section 4c(c) of the CEA, as amended by the 1978 Act. See 46 FR 33293, 33294 (June 29, 1981).

<sup>5</sup> See 46 FR 33293, 33294 (June 29, 1981).

<sup>6</sup> See 46 FR 54500, 54502 (November 3, 1981).

on a non-agricultural physical commodity.<sup>7</sup> The Commission continued to expand the pilot program in a controlled and orderly manner so that both the Commission and the exchanges would obtain greater experience with the trading of options,<sup>8</sup> subsequently expanding the pilot program to permit more option contracts per exchange,<sup>9</sup> to include option contracts on futures contracts on agricultural commodities,<sup>10</sup> and ultimately, to eliminate the pilot status of the option regulations.<sup>11</sup>

The Commission's incremental expansion of the domestic exchange-traded options program was validated by Congress in 1986 when Congress amended section 4c of the CEA to make permanent the program of exchange-traded commodity options. As stated in the House Report on the 1986 legislation:<sup>12</sup>

The Committee's amendment coincides with a recent decision by the Commission to terminate the pilot status of the program for trading options on futures contracts other than those on domestic agricultural commodities and make the trading of such options permanent. \* \* \*

The Committee believes the Commission has practiced good judgment in its regulation and oversight of both agricultural and the nonagricultural options programs. Furthermore, the Committee is satisfied that the overall experience with both of these pilot programs indicates that few regulatory problems have arisen, and that the exchanges have discharged their responsibilities adequately. Additionally, the Commission has detected no adverse effects on the underlying futures markets resulting from such option trading.

Moreover, based on its administration of the option pilot program for more than ten years, the Commission has previously determined to eliminate certain provisions that were originally

<sup>7</sup> 47 FR 56996 (December 22, 1982).

<sup>8</sup> *Id.* at 56997.

<sup>9</sup> See, e.g., 49 FR 33641 (August 24, 1984) (permitting each exchange to trade five contracts); 50 FR 45811 (November 4, 1985) (increasing from five to eight the number of contracts permitted per exchange).

<sup>10</sup> 49 FR 2752 (January 23, 1984). The pilot program was established after the statutory bar to trading options on domestic agricultural commodities was repealed by section 206 of the Futures Trading Act of 1982, Pub. L. 97-444, 96 Stat. 2294, 2301 (1983). The Commission limited the pilot program to options on futures contracts on agricultural products. The Commission noted that industry commenters generally favored such a restriction and the Commission's cautious approach. See 49 FR at 2754.

<sup>11</sup> See 51 FR 17464 (May 13, 1986) (termination of pilot status for non-agricultural options); 53 FR 777 (January 9, 1987) (termination of pilot status for options on non-agricultural physical commodities and on agricultural futures contracts).

<sup>12</sup> See H. Rep. 99-624, 99th Cong., 2d Sess. 15 (1986).

part of its options designation requirements for which there were not comparable futures regulation, such as:

—Rule 33.4(b)(9) which required a board of trade applying for designation as a contract market with respect to commodity option transactions to adopt special rules governing the handling by its member FCMs of discretionary accounts in option transactions;<sup>13</sup>

—rules which require boards of trade designated as contract markets for options to adopt rules requiring FCMs that engage in the offer or sale of commodity options regulated under Part 33 to send copies of customer complaints and their resolutions and copies of all promotional materials to the members' designated self-regulatory organization (DSRO);<sup>14</sup> and

—rules which required a specified volume of trading in the underlying futures contract prior to designation; established a delisting criterion for the trading of low-volume contracts; and required exchanges to provide a comprehensive list of occupational categories of commercial users of the commodity underlying the option.<sup>15</sup>

#### History of Foreign Options Rules.

As noted above, the Commission's initial pilot programs did not include foreign options.<sup>16</sup> Thus the ban contained in section 4c of the CEA remained in effect with respect to foreign options. A program to authorize the offer and sale of foreign exchange-traded commodity options was not implemented until 1987 with the general adoption of the part 30 rules governing foreign futures and option transactions generally.<sup>17</sup> The Part 30 rules, among other things, provided a mechanism for lifting the ban with respect to foreign exchange-traded options. Under rule 30.3(a), foreign exchange-traded commodity options are prohibited from being offered or sold in the United States unless the Commission issues a product-specific order. The part 30 rules did not similarly require a product-specific order for foreign futures transactions.

<sup>13</sup> 58 FR 30701 (May 27, 1993). The Commission based this rule change on its belief that compliance with the supervisory requirements of rule 166.3, the requirements of rule 166.2 concerning authorization to trade, other Commission rules of general applicability, and SRO rules such as NFA compliance rule 2-8, should be adequate to address the regulatory concerns applicable to both option and futures customer discretionary accounts. See 58 FR 30701, 30702.

<sup>14</sup> See 57 FR 58976, 58977 (December 14, 1992) (such records must however be maintained by the FCM for review as part of the routine audit process); see generally 56 FR 43694 (September 4, 1991).

<sup>15</sup> 56 FR 43694 (September 4, 1991). The Commission also revised rule 33.4(d) which had required exchanges to justify expiration dates of less than 10 days before first notice day or last trading day of the future, whichever comes first.

<sup>16</sup> See 46 FR 33293, 33294 (June 29, 1981).

<sup>17</sup> 52 FR 28980 (August 5, 1987).