Commodity Futures Trading Commission
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Forward Contracts with Embedded Volumetric Optionality

In accordance with section 712(d)(4) of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Commodity Futures Trading Commission (the "CFTC") and the Securities and Exchange Commission, after consultation with the Board of Governors of the Federal Reserve System, are jointly issuing the CFTC's proposed clarification of its interpretation concerning forward contracts with embedded volumetric optionality. The CFTC invites public comment on all aspects of its proposed interpretation.

Overview

In *Further Definition of "Swap," Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping* (the "Products Release"), the CFTC provided an interpretation, in response to requests from commenters, with respect to forward contracts that provide for variations in delivery amount (*i.e.*, that contain "embedded volumetric optionality").[1] Specifically, the interpretation, which consists of seven elements, identified when an agreement, contract, or transaction would fall within the forward contract exclusions from the "swap" and "future delivery" definitions in the Commodity Exchange Act notwithstanding that it contains embedded volumetric optionality. In response to requests from market participants, the CFTC is proposing to clarify its interpretation of when an agreement, contract, or transaction with embedded volumetric optionality would be considered a forward contract.

The Fourth and Fifth Elements

The CFTC is proposing to modify fourth and fifth elements of the interpretation to clarify that the interpretation applies to embedded volumetric optionality in the form of both puts and calls.

The Seventh Element

In response to commenters, the CFTC is proposing to modify the seventh element to clarify that the embedded volumetric optionality must be primarily intended, at the time that the parties enter into the agreement, contract, or transaction, to address physical factors or regulatory requirements that reasonably influence demand for, or supply of, the nonfinancial commodity.

The CFTC is further proposing to clarify that the phrase "physical factors" should be construed broadly to include any fact or circumstance that could reasonably influence the parties' supply of or demand for the nonfinancial commodity under the contract, including environmental factors, relevant "operational considerations," and broader social forces, such as changes in demographics or geopolitics. Concerns that are primarily about price risk, however, would not satisfy the seventh element absent an applicable regulatory requirement to obtain or provide the lowest price.

The CFTC is also proposing to clarify that electric demand response agreements may be properly characterized as the product of a regulatory requirement within the meaning of the seventh element.

[1] *See* 77 FR 48207, 48238-42 (Aug. 13, 2012).