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Grabby

U.S. market regulators have little say over large portions of trading in derivatives markets—the entire overseas business, for example, and the privately negotiated contracts known as swaps. This is a state of affairs that drives them and their friends in Congress crazy. So in recent years the Commodity Futures Trading Commission has used the troubles of innocents such as a Procter & Gamble or a Metallgesellschaft to assert the need to control swaps, collars, floors, and other risk-management arcana practiced by consenting adults.

Lawmakers have been only too ready to join in the scaremongering, and now it's time to invoke Sumitomo, where one trader, Yasuo Hamanaka, managed to lose $1.8 billion in copper trades. Today the House Banking Committee under Jim Leach (R., Iowa) will hold a hearing that aims to establish Sumitomo as the pretext for a fresh round of intervention. Chuck Schumer (D., N.Y.) will be hawking a bill that looks to us like an extraterritorial lunge. It says to prevent future Sumitomos it "would grant the CFTC full authority to regulate foreign futures for U.S. delivery in the same manner that it regulates futures contracts on U.S. exchanges." Also this week, Richard Lugar (R., Ind.) and Patrick Leahy (D., Vt.) took their new commodities bill, a generally encouraging bit of legislation, and dropped language into it requiring and empowering the CFTC to monitor any warehouses on U.S. soil that might house goods deliverable under a contract between foreign parties written on a foreign exchange.

Now, Sumitomo is a Japanese company, and Mr. Hamanaka was based in Tokyo. He built much of his catastrophic position on credit from brokers on the London Metal Exchange. U.S. (and French) banks offered some financing after the trader had run through his LME lines—and been subject to numerous LME inquiries. But at worst, these banks were doing what banks do—lending money. Their efforts in any case came too late for Mr. Hamanaka's project. Just who are the American victims here?

Absent bleeding witnesses, the regulators and lawmakers have made the focus of their intervention efforts the fact that the London Metal Exchange's copper warehouses were located in California, raising the image of the CFTC conducting dawn raids in Long Beach. In an interconnected world economy and world financial system, any transaction is likely to touch U.S. territory. Under the Schumer theory, this offers American regulators license to regulate the world's trading. At their Chicago Convention, ranking Commerce Committee Democrats were busy readying a legislative strategy should Democrats recapture the House; the unfortunate word is that aggressive derivatives legislation was a high priority on their agenda.

Mr. Schumer argues he's after a level playing field. He also says he is protecting Brooklyn consumers from market manipulation and price movement—"something had obviously gone wrong in the copper market." But, of course, the CFTC can't prevent market volatility: Robert Mackay, a derivatives expert, points out that corn, a product well within the ag agency's bailiwick, moved up 50% in the last quarter of 1994. The proposed legislation is not about the price of copper. Markets grow faster under lighter regulation, the swaps market and London Metal Exchange being cases in point. U.S. exchanges such as the New York Mercantile Exchange—a supporter of this bit of silliness—push the Chuck Schumers of the world into writing laws that go after that growth.

The result, of course, would be that the U.S. loses. To avoid tripping the Schumer wire, holders of foreign contracts would move their deliveries out of the United States. American exchange firms would eventually lose trades, market share and future business. So, for that matter, would American warehouses.