Bid to Overhaul Futures Trading Sparks Debate

WSJ **COMMODITIES** C1

2/18/97 By AARON LUCCHETTI And JEFFREY TAYLOR

Staff Reporters of THE WALL STREET JOURNAL

New legislation to overhaul futures trading has set off debate about how much regulation is required to patrol the growing and often-volatile markets.

Last week, the Senate Agriculture Committee held hearings on a bill that would curtail the powers of the Commodity Futures Trading Commission, the main U.S. regulator of the markets on which futures and options change hands. Futures exchanges and others who believe the industry would thrive with less oversight applauded the bill's deregulatory bent. But the agency itself warned of dire consequences if the bill, introduced by Sens. Richard Lugar (R., Ind.), Tom Harkin (D., Iowa), and Patrick Leahy (D., Vt.), becomes law.

Strong sentiment in favor of deregulation in the Republican-controlled Congress boosts the bill's chances, congressional aides say. And even longtime supporters of the CFTC and the Securities and Exchange Commission concede that the bill has significant support, at least in the Senate. In the House, Rep. Tom Ewing (R., Ill.) has introduced a similar bill, but it faces staunch opposition from Democrats such as Edward Markey of Massachusetts and John Dingell of Michigan, traditional allies of financial-markets regulators.

"There's clearly a mood for being as thoughtful as possible about how much regulation is really necessary," Sen. Lugar, chairman of the Agriculture Committee, said in an interview. "We've put a lot of thought into this bill."

The CFTC says the bill would set

Please Turn to Page C23, Column 1

Debate Flares Over Futures Deregulation

WSJ *Continued From Page C1* 2/18/97

futures-trading back severely, subjecting investors to a world of potential lawlessness. The bill's provisions include shortening the approval process for new futures contracts to as little as 10 days from 90 days, requiring regulators to measure the costs and benefits of any new rules and encouraging the CFTC to pass some duties to exchanges or self-regulatory bodies.

Brooksley Born, chairwoman of the CFTC, told the Senate committee she fears the bill's provisions would "eliminate federal power to protect against manipulation, fraud, financial instability and other dangers." The CFTC cited recent debacles, such as Sumitomo Corp.'s $2.6 billion copper-trading loss, as reasons to enhance, rather than cut, its mandate.

Much of the CFTC's concern stems from a controversial provision that allows futures exchanges to offer separate, less-regulated markets for the professional-investor class of banks, companies, funds and wealthy individuals, which together account for more than 90% of exchange business.

If the legislation passes, exchanges are expected to woo new business from what is known as the over-the-counter derivatives market — a flourishing, $50 trillion market of trading products such as forwards, swaps, and customized options that fall outside the CFTC's umbrella. With professional markets, exchanges would be able to offer more-customized contracts to users who now deal largely in over-the-counter markets or on less-regulated foreign exchanges that offer products tailored to specific needs. That trend, exchanges say, has caused the U.S. share of futures and options trading world-wide to drop to 38% from 75% over the past nine years.

The Chicago Board of Trade says volume in its 30-year Treasury futures contract has risen only 54% in the last five years, while the over-the-counter market for interest-rate swaps grew fivefold. "If we can't provide a regulatory environment that fosters our ability to innovate, our markets will disappear," says Patrick Arbor, CBOT chairman.

The CFTC argues its regulations ensure price transparency and reduce risk. But industry officials contend those benefits wouldn't disappear under a new regulatory regime limiting the agency to antifraud, antimanipulation and emergency powers. Despite probable reductions in trade reporting requirements, customers will still demand the protection of funds and the backing of trades through clearinghouses, says Hal T. Hansen, president of Cargill Investor Services Inc. "If it lacks those basic structures, no knowledgeable entity will participate," he adds.

The CFTC must also battle other powerful adversaries, such as the Treasury Department, which supports the bill's provision that would limit the CFTC's oversight of off-exchange trading in foreign currencies and certain other financial instruments. The Treasury and the Senate committee bill urge that the CFTC's jurisdiction in these markets be limited to off-exchange products that aren't regulated by other government arms but that are offered to the general public.

"We see no need for the CFTC to have jurisdiction over the retail activities of banks, broker-dealers and investment companies," Roger L. Anderson, the Treasury's deputy assistant secretary for federal finance, told the Senate committee last week.

The CFTC has some allies, but for different reasons. Stock exchanges, stock-option exchanges and the SEC disagree with a proposal to exempt dealers in stock swaps from CFTC authority; they fear it would allow legal arguments that the instruments are exempt from regulation.

During the hearings last week, Sen. Lugar was at pains to point out that the bill's provisions "are not set in stone." Some of them, he said, are "deliberately bold" and may be changed during the bill's markup period. Other lawmakers think the bill's evolution may resemble that of a securities bill enacted into law last year, in which radical deregulatory initiatives were softened substantially to win support from Democrats and the SEC. The bill may also face hurdles in the shape of other congressional committees, such as the House Commerce Committee, which may claim jurisdiction over some parts of the bill and soften some provisions.

Either way, the futures industry is bracing for change. "Whether or not all the provisions pass," says Daniel Rappaport, chairman of the New York Mercantile Exchange, "we think this is a watershed event for the industry."

90