

UNITED STATES OF AMERICA
COMMODITY FUTURES TRADING COMMISSION

2033 K Street, N.W.
Washington, D.C. 20581



May 4, 1992

The Honorable Glenn English
Chairman
Subcommittee on Conservation,
Credit, and Rural Development
House Committee on Agriculture
2206 Rayburn House Office Building
Washington, D.C. 20515

Dear Mr. Chairman:

Thank you for your April 14, 1992 letter concerning your proposed definitions of futures and forward contracts which may be considered in the pending Conference on CFTC reauthorization.

As you know, we have worked together over the past months to provide technical assistance in drafting a definition of a futures contract even though the Commission does not support that approach. We appreciate your efforts to seek our advice, and we respect the hard work that you have put into this endeavor.

After reviewing several drafts of a futures definition, however, the Commission is even more aware of the perils of trying to define the term in a satisfactory manner. As a result, we believe even more strongly that adding a futures definition to the Commodity Exchange Act (CEA) could cause uncertainty and disruption in the marketplace.

The Commission shares with you the goal of ensuring that U.S. futures markets are safe and competitive, but does not believe that defining either a futures or a forward contract in the CEA would advance that cause. Instead it would likely create enforcement or jurisdictional problems. The Commission does recognize the benefits of the broader exemptive authority accompanying your futures definition proposal, but our reservations about the definition itself remain. Accordingly, we continue to strongly support Title III of the Senate amendments to H.R. 707 as the best way of achieving our common goals.

Futures Definition. From a jurisdictional perspective, the proposal could be construed to expand the definition of a future in some respects so that existing products could be classified as illegal, off-exchange futures contracts. Due to the exclusive

jurisdiction and preemption provisions of the CEA, the CFTC may suddenly become the regulator of products traditionally regulated by the Securities and Exchange Commission or applicable banking regulators. Even if the CFTC could use its new exemptive authority to exempt products that would now inappropriately come under CEA regulation, new regulatory gaps could occur since these products would no longer be under the oversight of their previous traditional regulators. Furthermore, the introduction of a definition could disrupt markets, effectively causing certain markets to cease trading or to move their trading activities to a more certain legal environment.

In addition, because the CFTC's previous interpretations are grandfathered for only one year after the legislation is enacted, the Commission would have significant demands for additional resources to meet the expected surge in requests for exemptive relief under the new authority. The time and cost associated with such a process would be unpredictable and would create additional uncertainty in the market, and further discourage product development. Markets could be disrupted and many commercial interests could be expected to execute their transactions outside the U.S.

While too broad a definition could create problems for other regulators and for the forward and cash market, an overly restrictive definition could create enforcement difficulties for the CFTC. Although the Commission now must prove the elements of a futures contract in enforcement actions, it is able to do so by building a record that reflects a range of relevant facts so that courts can view transactions as a whole. A statutory definition could limit such flexibility, and could provide a "roadmap" to sellers of illegitimate off-exchange futures contracts who would design new forms of futures products outside the definition, thus hindering the CFTC's ability to police off-exchange fraud. Even boiler rooms selling more commonplace off-exchange products are likely to argue that their activities are not covered by the new statutory terms.

Forward Contract Definition. Although the Commission recognizes that a forward contract definition is included in the proposal to alleviate concerns associated with the proposed futures contract definition, we believe a forward contract definition, in itself, is unnecessary. The Congress has already made clear in section 2(a) of the CEA that "[t]he term 'future delivery' as used herein, shall not include any sale of any cash commodity for deferred shipment or delivery," i.e., cash forwards.

The new definition of a forward contract appears to include transactions by non-commercial entities and to hinge on the subjective intent of one party to the transaction. In these respects, like the futures definition, the forward definition may give rise to concerns about creating a roadmap for illegitimate sellers of off-exchange products who will seek to rely upon the forward definition to assert that their retail customers "intended" to take delivery. In the Commission's experience, commercial reality dictates that the legality of a forward contract be based upon the objective standard of a legally enforceable obligation between commercial entities to make or take delivery, coupled with the commercial capacity to do so.

Exemptive Authority. As previously stated, we support the exemptive authority contained in Title III of the Senate amendments. We agree that your proposal to delete the restriction in Title III limiting exemptions only for transactions targeted to institutional participants is a constructive change.

Although we are unable to endorse all of the aforementioned elements of the draft proposal, we commend your efforts to finalize a proposal which can be considered by the Conference Committee in the near future. Let me reiterate the Commission's belief that provisions in both the House and Senate bills are essential to strengthen the Commission and to protect the integrity of our nation's futures markets.

We share your concern about regulatory "black holes." Indeed, the rapid pace of financial innovation in the U.S. in recent years has raised questions for regulators as they have tried to determine how to regulate products that were unheard of when the statutes they enforce were enacted. This is the inevitable result of rapid innovation.

On the whole, U.S. futures markets have been the world's most innovative, in part because the CFTC has been able to be flexible in its regulatory reaction to new market developments. By adapting to these developments, the regulatory system has evolved with the market. In order to continue to do so there must be new legislation which will give regulators additional flexibility and authority to deal with the unpredictable products which the next ten years will bring. We believe Title III will provide us with the necessary tools to effectively deal with the regulatory challenge ahead.

All Commissioners at the CFTC are eager to see the Congress act on the Commission's reauthorization legislation as soon as possible this year. If I can be of further assistance to you in this process, please do not hesitate to contact me. We appreciate your long-standing leadership and consistent support

in our combined effort to maintain the economic well-being of the
U.S. futures markets.

Sincerely,

A handwritten signature in cursive script that reads "Wendy L. Gramm".

Wendy L. Gramm
Chairman