

U.S. house of Representatives
Committee on Energy and Commerce
Room 2125, Rayburn house Office Building
Washington, DC 20515

March 17, 1988

The Honorable Wendy L. Gramm
Chairman
Commodity Futures Trading Commission
2033 K Street, N.W.
Washington, D.C. 20581

Dear Chairman Gramm:

Pursuant to Rules X and XI of the Rules of the U.S. House of Representatives, and our continuing oversight of the federal securities laws and markets, we request at this time that the Commission provide further clarification and information regarding one specific issue, frontrunning, which was addressed in the January 1988 report by the Commission's Divisions of Economic Analysis and Trading and Markets. We will be asking your assistance on other issues in future correspondence.

Concerning frontrunning, the CFTC's final report suggests that standards be established to identify potential intermarket frontrunning patterns and a mechanism be established to effectively communicate market surveillance data to all exchanges related to possible frontrunning activities. CFTC staff also is considering the possibility of regulatory action on frontrunning. Please provide the Subcommittees with answers to the following:

- 1) Please identify and summarize all enforcement actions taken to date by the CFTC and the exchanges regarding frontrunning. Include in your summary, the specific regulatory or statutory authority under which each action was taken and the maximum penalties authorized to be taken and those actually assessed in each case.
- 2) According to the CFTC's final report, "[s]ection 8(c)(1)(A) of the Commodity Exchange Act provides that, if an exchange fails to act, the Commission may take disciplinary action in accordance with the exchange's rules." Identify and describe all instances where the CFTC has taken disciplinary action against an exchange in regard to frontrunning.

- 3) The CFTC's final report also notes that "[w]hat constitutes frontrunning under particular market circumstances is not always clear." Identify the "particular market circumstances" where it is unclear whether frontrunning has or has not occurred. Explain why such circumstances are ambiguous.
- 4) Identify and provide copies of the current federal or SRO regulations or rules which prohibit intermarket or intramarket frontrunning and the penalties which may be assessed under each specific prohibition. In addition, cite all relevant statutory provisions and applicable penalties under which frontrunning enforcement actions may be brought.
- 5) Set forth specifically your views on the issue of whether the Commission should or should not adopt a rule which prohibits intermarket and intramarket frontrunning. Include in your answer a description of any actions undertaken to date concerning the possibility of pursuing such a rulemaking.
- 6) Describe the surveillance methods used to detect frontrunning. Include in your answer a detailed description of joint surveillance efforts existing between the SEC and the CFTC. In addition, describe the thrust of proposals currently being discussed concerning ways in which the futures exchanges can be formally included in deliberations of the Intermarket Surveillance Group.
- 7) What specific actions did the CFTC undertake to determine if frontrunning occurred during October 1987? What specific actions has the CFTC undertaken prior to October 1987 to detect frontrunning abuses?
- 8) How many instances of possible frontrunning have you identified during October, 1987? For each such instance, without disclosing the identity of the participants, please describe the nature and magnitude of such instances.
- 9) Provide copies of written statements from the exchanges to member firms or the CFTC concerning prohibitions on frontrunning.
- 10) Explain whether exchange audit trails should not only include the identity of the clearing member and executing broker but, in addition, the identity of the end customer.

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Your response should be delivered to the Subcommittees no later than the close of business on Friday, April 8, 1988. If you should have any questions concerning this request, please do not hesitate to contact us immediately. Thank you for your cooperation.

Sincerely,

JOHN D. DINGELL
CHAIRMAN
Subcommittee on Oversight
and Investigations

EDWARD J. MARKEY
CHAIRMAN
Subcommittee on
Telecommunications and
Finance