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United States Senate

COMMITTEE ON
 AGRICULTURE, NUTRITION, AND FORESTRY
 WASHINGTON, DC 20510-8000

June 19, 1992

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

Dear Chairman Gramm:

As you know, the Chicago Mercantile Exchange and Chicago Board of Trade boards have decided to reduce "performance bond" or "margin" requirements for their respective futures contracts on the Standard & Poor 500 index and Major Market Index, effective Monday, June 22, 1992. Last month, the New York Futures Exchange reduced margin requirements for its futures contract on the NYSE composite index.

Margin levels for stock-index futures have been the subject of substantial debate and controversy following the stock price crashes of 1987 and 1989. To assure public confidence in the adequacy of these margin levels to protect financial integrity and avoid financial risk, the Senate passed legislation (Title III of S.207, the Futures Trading Practices Act) which requires that these levels be reviewed and overseen by a Federal agency. Ultimate authority would rest with the Federal Reserve Board, though it may delegate authority under this provision to the CFTC.

This legislation remains pending in a House-Senate conference committee where it has been since last November. We remain optimistic that a final package will reach the President's desk this year -- with the margin provision included.

The decisions by the CME, the CBT, and NYFE with respect to margin levels on the S&P 500, MMI, and NYSE composite contracts would fall squarely under the title III provision were it law.

We are concerned about the timing of these decisions and the signals they may send. This concern is magnified by the fact that they will not be subject to Federal review under title III.

Stock markets both domestic and abroad have witnessed increasing volatility in recent days and weeks. Just this week, the U.S. market absorbed a single-day drop of 41 points in the Dow Jones Industrial Average and a 6 points in the Standard and Poor 500. Over the last two days, the Tokyo Nikkei Average has fallen over 900 points. Similar losses have been seen in other markets world-wide.

Day-to-day volatility in stock prices over the past year or so may be below prior levels, but it takes only a single day of serious, disproportionate losses -- particularly if paired with lowered margins -- to damage public confidence and to reignite public controversies similar to those of 1987 and 1989.

We cannot expect the CME, the CBT, NYFE, or other exchanges to put off making day-to-day decisions on such market-sensitive issues as margin levels until Congress completes action on the pending CFTC bill -- particularly given the many delays in that process. But the public concern that gave rise to the legislation remains deep and cannot be ignored.

As an alternative until Congress has finalized its work on the bill, we request that the CFTC conduct a review of the proposed changes in stock-index futures margin levels under the title III standard: that is, we ask that you examine whether the levels are "appropriate to preserve the financial integrity of the contract market or its clearing system and to prevent systemic risk." In assessing the potential impact on systemic risk, we urge you to seek input from interested officials at the Department of the Treasury, the Federal Reserve Board, and the Securities and Exchange Commission, as appropriate.

While current law does not authorize the CFTC to approve or disapprove, or to alter or supplement exchange rules setting levels or margin, there is no bar in the Commodity Exchange Act against the CFTC conducting a review or analysis of margin levels to satisfy itself as to their adequacy in light of the public interest and reporting its findings to Congress. We have separately asked the exchanges to cooperate fully in this process and to reconsider their margin decisions should the CFTC determine, as a result of its review, that it has concerns about the adequacy of the proposed levels.

Please report to the Committee on your findings within ten days.

In asking you to conduct this review, we emphasize that this interim procedure is no substitute for the legal review power for stock-index futures contracts granted to the Federal Reserve Board under title III of the legislation. Rather, the need to turn to this essentially-voluntary procedure speaks eloquently to the need for Congressional action on CFTC reform legislation this

year. The financial world will not simply stop turning while waiting for Capitol Hill to act.

We appreciate your assistance on this matter of significant public interest.

Sincerely,



PATRICK LEAHY
Chairman



RICHARD G. LUGAR
Ranking Member