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Congress of the United States
House of Representatives
Washington, DC 20515

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May 31, 1996

Mr. John E. Tull, Jr.
Acting Chairman
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW--Room 9034
Washington, DC 20581

Dear Chairman Tull:

I am writing to seek your assistance on a matter that has recently come to my attention.

As you know, Section 3 of the Commodity Exchange Act, as amended (the "Act"), sets forth the "national public interest" in futures trading that requires federal oversight and justifies the need for the Commodity Futures Trading Commission (the "Commission"). Specifically, Section 3 of the Act acknowledges that futures and options transactions are utilized for pricing and risk-shifting in the United States and foreign countries. The Act and the regulatory structure under the Act exist to protect the prices of those commodities on boards of trade from improper influences in order to benefit interstate commerce in commodities and benefit the national economy as a whole. I am concerned that the Act may no longer properly provide for the intended protection of the public interest, for the reasons set forth below.

Drastic changes in the international financial markets seem to have created an issue as to how well that public interest can be protected under this regulatory regime. As an example, I attach two recent articles from the Financial Times reporting on a squeeze in the copper market operated by the London Metal Exchange. As you know, copper is permitted to be delivered on the LME copper contract in warehouses located in the United States. Thus, the price of copper in U.S. commerce is directly at risk to a squeeze on the London Metal Exchange. This situation concerns me.

Section 4(b) of the Act limits the ability of the Commission to exercise oversight over foreign boards of trade, even if the activities on the foreign board of trade could affect interstate commerce in a particular commodity and in the United States economy in general. I refer to the limitations in Section 4(b) providing that:

> No rule or regulation may be adopted by the Commission under this subsection that (1) requires Commission approval of any contact, rule, regulation, or action of any foreign board of trade, exchange, or market; or (2) governs in any way any rule or contract term or action of any foreign board of trade, exchange, or market, or clearinghouse for such board of trade, exchange, or market.

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My understanding is that the only means by which the Commission can protect the public against the risk to the economy from improper practices on foreign boards of trade adversely affecting the prices of commodities in U.S. commerce are: (1) by regulating the conduct of professionals marketing foreign futures in the United States; or (2) by prohibiting the offer and sale of foreign options in the United States or by conditioning an exemption under Part 30 of the Commission's regulations permitting the offer and sale of foreign options in the United States. Is this a correct interpretation?

I would also like to request, at your earliest convenience, responses to the following related questions:

(1) What analysis goes into the decision to permit professionals to engage in the offer and sale of a foreign future in the United States, without registration or further disclosure or other requirements? For what public input and review does the process provide?

(2) What analysis goes into the decision to grant a Part 30 exemption? For what public input and review does that related process provide?

(3) How frequently are the permissions, exemptions and/or conditions referred to in questions (1) and (2) reviewed, following the initial grant of permission, exemption or imposition of a condition?

(4) What analysis, review and approval process exists to address a decision by a foreign board of trade to list a contract calling for future delivery of a commodity within the United States?

(5) What information does the CFTC have the right to obtain with respect to recent activities in copper traded on the LME and with respect to actions of the LME Board to respond to those activities? Have the Commission's efforts to exercise those rights of access, if any, been successful, or have they been impeded or limited in any respect, either because of limitations in their scope or otherwise?

(6) What authority does the CFTC have to prevent, respond to, or sanction conduct with respect to a squeeze on a foreign market where the contract calls for dealing in US commerce? In what respects is that authority not co-extensive with the CFTC's authority with respect to conduct related to activities on a U.S.-designated contract market?

(7) Is this legislative/regulatory framework sufficient, in your view, to protect the national public interest in commodities prices from improper conduct on a foreign board of trade? Would your answer be the same if the futures or options contract called for delivery of a commodity within the United States?

Thank you very much for your consideration, and I look forward to your response. Please do not hesitate to call if you have any questions or would like further clarification of my concerns.

Sincerely,

Charles E. Schumer

Charles E. Schumer
Member of Congress

FINANCIAL TIMES THURSDAY MAY 9 1996 ★★

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LME acts to limit impact of copper market squeeze

By Kenneth Gooding, Mining Correspondent

The London Metal Exchange board took action yesterday to limit the impact of a technical squeeze rapidly developing in its copper market. Traders suggested that US hedge and commodity funds were on the wrong end of the squeeze and were likely to suffer big losses after going short – selling metal they did not own in the expectation that they could buy later and make a profit.

The LME imposed a limit on the cost of carrying forward a short position for one day. From today holders of short positions who are unable to deliver copper must pay a penalty of 1 per cent of the previous day's official settlement price. Yesterday's settlement price was $2,833 a tonne. Before the LME's action it was costing about $2 a tonne to carry forward a short position for a day but this increased to $3 shortly afterwards.

Analysts were surprised by the intervention. One suggested: "We can only assume that Mr King [Mr David King, the LME chief executive] saw something in the confidential daily reports from brokers which alarmed him and the action was to pre-empt a disorderly situation".

They pointed out the board had not taken action at times when the copper squeeze had seemed to be more severe – for example in December when the backwardation (premium for copper for immediate delivery compared with three-month metal) had risen to $320 a tonne.

Last night the backwardation was $147.75 a tonne after cash copper closed up $53 at $2,845.25 while three-month metal was $2,697.50, up $34.50.

Mr King refused to be drawn about the reasons the board acted after its scheduled monthly meeting. He did refute suggestions that the exchange had "baled out the shorts." He said: "We have never baled anybody out and we will not while I am chief executive".

Analysts said a strike at Chuquicamata in Chile, the world's biggest copper mine, problems at RTZ-CRA's new Bingham Canyon smelter in the US and low stock levels were combining to make consumers nervous about copper deliveries in June.

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FINANCIAL TIMES THURSDAY MAY 23 1996

LME copper hit by fresh turmoil

By Kenneth Gooding, Mining Correspondent

Fresh turmoil and volatility swept the London Metal Exchange's copper market yesterday as the "longs" and the "shorts" battled for the upper hand. The conflict saw the price for delivery in three months drop by $100 a tonne in morning trading only to regain all the lost ground by the close.

Analysts said that such "choppy" conditions frequently followed sharp falls in metal prices of the kind copper has seen since last Friday as the market searched for a level at which it could consolidate. "This volatility could go on for days or even a week or so," one said last night.

Three-month copper dropped to $2,345 a tonne at one point, its lowest level for two years and nearly 14 per cent below the 1996 peak of $2,715 touched as recently as May 9.

As the "shorts" – those who had sold copper they did not own in the expectation that they could buy later at a lower price – struggled to cover, the price rebounded to a day's high of $2,446. Three-month copper closed at $2,430, virtually unchanged from Tuesday.

Meanwhile, the ferocious technical squeeze that has gripped the market for some months continued to make itself felt. The premium for copper for immediate delivery compared with three-month metal widened during the day from $60 a tonne to $110.

Analysts said this indicated that LME stocks were tightly held. "It is very dangerous to go short at a time like this," said one analyst. "The shorts will win eventually because so much extra copper will be produced this year, but it will be a bloody battle."

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FAX FROM U.S. REP. CHARLES E. SCHUMER'S WASHINGTON DC OFFICE

DATE 5/31/96

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FROM: MR. SCHUMER

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NUMBER OF PAGES: (including this page) 5

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Comments:

– PLEASE SEE ATTACHED –