IT is my pleasure to be here today to speak to your distinguished group on a subject of very real importance: regulation and supervision of the futures market.

If we may look for a moment at the historical relationship between the United States Government and the Chicago Board of Trade, we gain a real insight into regulation in this field. Of equal interest, we can see how public attitudes have changed over the years and how the Board itself has matured and developed as a responsible public service institution.

Today the Chicago Board of Trade is the largest and most important commodities exchange in the world. It is the world's largest cash market for such crops as corn and soybeans; it handles 90 per cent of the world's grain futures trading. In fiscal 1964, the value of commodities traded at the Board exceeded 50 billion dollars, an amount equal to about half our national budget and an amount larger than that appropriated by Congress for the same year for the U.S. Army, Navy and Air Force.

The Board is recognized today as an integral part of our economy, not just because of the volume of trading done on the floor, but because of the essential services which it provides to
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farmers, exporters — indeed, to all of American agriculture. These services are directly related to the Board’s development as a self-regulating institution under limited government supervision. They are also a reminder of the responsibility the Exchange bears when it speaks of serving the public interest.

As we look at regulation and supervision, it might be well to examine the people and organizations that constitute this market. As you know, cash or spot trading involves the purchase or sale of commodities, usually for immediate delivery. More important is the designation of specific times and qualities tailored to the particular needs of the buyer. Among the Exchange members in cash grain trading are those representing country grain elevator operators, farmer cooperatives, terminal and subterminal warehousemen, transportation interests, bankers and grain processors.

Most of our trading, of course, is in the highly impersonal futures contracts. Approximate delivery time and location and quality of delivered commodities are known within limits specified by the futures Exchange. This type of trading involves many of the people already mentioned, but also introduces the floor trader, including pit brokers, and commission houses as representatives of outside commercial interests and speculators.

Regulation, as grain standards, for example, and service, such as grain inspection and market news dissemination, are among the valuable government contributions to both markets.

This recapitulation serves another purpose, however: that of refreshing your memory as to the wide span of interests represented in the membership. Those who are elected officers, serving this association, and those who do the committee work, as well as our professional staff members, must do their utmost to work for the best interests of all. And it must be done within the framework of general public interest.

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Generally, the Exchange will manifest itself to the public in one of three ways:

First, the continuous futures trading, coupled with press, radio and ticker coverage provides basic information on the course of commodity prices. This information is invaluable to the farmer. It tells him the value of his crop and guides his most important decisions. It also guides the processor, the dealer and the exporter in their decisions on inventory and pricing.

Second, futures trading provides farmers, processors, and dealers with a continuous, year-round market for all agricultural products, whether in storage, growing, or not yet planted. It makes possible the rapid turnover and distribution of commodities, and in doing so it helps to stabilize prices.

Third, futures trading permits those who deal in commodities to "hedge", or insure against changes in commodity prices. The grain elevator operator, for example, must make a cash market commitment at today's price. The futures market enables him to take an opposite position in futures for the same commodity. Thus, any loss he might suffer on one contract will be largely offset by his profit on the other. Since prices in the futures market tend to correspond to the course of cash commodity price movements, the result is a cheap and practical form of price insurance for those who bear the risks of producing, storing, processing and marketing grain.

The futures market, then, fulfills three vital functions in American agriculture: (1) it provides essential price information; (2) it provides a liquid, year-round market in all commodities; (3) it provides hedging facilities for farmers, dealers, processors, exporters and others who bear the risks of agricultural production and marketing.

We may note that the professional trader in futures contracts, the speculator, is an indispensable man in this complex
system. If there were no speculators to accept the offers of hedgers wishing to buy or sell futures contracts, hedging would become difficult, if not impossible. If there were no speculators engaged in the rapid buying and selling of futures contracts, the market would lose liquidity, and its thinness would encourage excessive price fluctuations. Actually, if there were no speculators, there would be no futures market, and I can think of no system that would perform the marketing task with equal efficiency. The need for speculation is frequently not understood by those not intimately associated with this market, and this is one reason we so zealously guard our rights to self-regulation.

With all this in mind, let me take you back to the year 1890 when Congressman Butterworth of Ohio introduced a bill placing a prohibitive tax upon dealers in futures, and Representative Funston of Kansas described the futures market as follows:

"Those who deal in 'options' and 'futures' contracts, which is mere gambling, no matter by what less offensive name such transactions may be designated, neither add to the supply nor increase the demand for consumption, nor do they accomplish any useful purpose by their calling; but on the contrary, they speculate in fictitious products. The wheat they buy and sell is known as 'wind wheat' and doubtless for the reason that it is invisible, intangible, and felt or realized only in the terrible force it exerts in destroying the farming industry of the country."

Two years later, on the floor of the Senate, Senator Washburn stated:

"As near as I can learn, and from the best information I have been able to obtain on the Chicago Board of Trade, at least 95% of the sales of that Board are
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of this fictitious character, where no property is actually owned, no property sold or delivered, or expected to be delivered but simply wagers or bets as to what that property may be worth at a designated time in the future . . . Wheat and cotton have become as much gambling tools as chips on the faro bank table. The property of the wheat grower and cotton grower is treated as though it were a ‘stake’ put on the gambling table at Monte Carlo. The producer of wheat is compelled to see the stocks in his barn dealt with like the peas of a thimble-rigger, or the cards of a three-card-monte man. Between the grain-producer and the loaf-eater, there has stepped in a ‘parasite’ between them robbing them both”.

These speeches by members of Congress show how a large part of the American public felt about the Board in the days before its essential functions were understood. The Board was pictured as a gambling den made up entirely of speculators. The speculator was regarded as a mere parasite who siphoned off into his own pocket profits or savings which should rightfully have gone to the farmer or the consumer.

I might add that there are those today who hold nearly the same view so prevalent in those “good old days.” There is still work to do.

This view led to repeated attempts by the Illinois legislature and by the Congress of the United States to abolish futures trading altogether. For example, in 1867 an Illinois Act provided that the parties to future contracts, which were called “gambling” contracts, should be fined $1000 and imprisoned for a period of up to one year in the Cook County Jail. Seven members of the Board were actually arrested under this Act, and an historian tells us that “The members in a body escorted the prisoners to hacks . . . and they were
drawn off (by the police) while the members cheered."

This particular Act was repealed the very next year, but in the course of the next fifty years literally *hundreds* of bills banning all trading in futures were introduced in Congress. We might ask, "Why?"

In part, as I have already said, economic misconceptions were at the root of the anti-Board agitation. Futures trading seemed to many to be a game in which fortunes were made on "fictitious" purchases and sales. Moreover, it appeared to some to be a form of "gambling" and therefore sinful.

Then again, there were those who believed that the law of supply and demand did not work out as well in agriculture as it was supposed to elsewhere. There were droughts and natural disasters, as well as economic depressions in the 1870's, the early 1920's and, of course, the '30's, which led farmers and the general public both to seek a scapegoat. The Board of Trade has always been a convenient scapegoat in times of falling farm prices.

In addition, we must recognize that there were some abuses connected with futures trading. The public was familiar with those few dramatic incidents in which speculators attempted to corner the markets in various commodities. This kind of attempted market manipulation by a few men was not only dangerous in itself — it prevented the public from understanding the importance of the real day-to-day business of the Board.

Recognizing these dangers, the leadership of the Board introduced rules and regulations against attempted corners and other manipulative devices as early as the 1860's. As the necessity for self-regulation became better understood, the Board cleaned house in other ways as well — for example, by cracking down on bucket shops and the bucketing of orders by members, by imposing margin requirements on trade in
specific commodities, and by opposing the trade in "puts" and "calls".

As a result, the public and the Federal Government began to realize that abuses could be eliminated without impairing the independence of the Board or the functions of the market. In 1908, President Theodore Roosevelt in a special message to the 60th Congress, spoke out against attempted corners, but without suggesting any radical changes in the organization of the market.

Progress continued. In the early 1920's, the Board established a Business Conduct Committee to supervise the activities of individual members and to work with the Department of Agriculture in providing an orderly market. As a result of the growing cooperation between the Board and the Government, a bill to abolish futures trading which was introduced in the Senate was opposed by two Secretaries of Agriculture. They urged that no legislation which interfered with the hedging function performed by the futures market should be considered.

Obviously, both the Board and the Government had come a long way. The degree of mutual understanding which they had achieved was reflected in the first Federal Statute regulating the futures market — The Grain Futures Act of 1922, and in its successor, the Commodity Exchange Act of 1936, which is still the chief statute regulating the futures market. This legislation did not attempt to abolish trading in futures either in whole or in part. On the contrary, it was carefully aimed at certain specific abuses. As President Roosevelt said in 1934:

"The exchanges in many parts of the country, which deal in securities and commodities conduct, of course, a national business because their customers live in every part of the country. The managers of
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these exchanges have, it is true, often taken steps to correct certain obvious abuses. We must be certain that abuses are eliminated, and to this end a broad policy of national regulation is required”.

The Commodity Exchange Act, as amended, seems in historical perspective to be one of the wiser regulatory statutes enacted by the Federal Government. The Act limits futures trading to established “contract markets” such as the Board of Trade, and establishes a Commodity Exchange Commission including the Secretary of Agriculture, Secretary of Commerce and the Attorney General. The Commission is given authority to collect detailed information on the day-to-day operation of the exchanges and to fix limits on the amount of trading done under contracts of sale for particular commodities. Hedging transactions, however, are specifically exempted from the operation of these provisions.

The Act prohibits contracts designed to defraud or mislead and outlaws certain other deceptive or dangerous practices. It provides for registration of commission merchants and brokers and allows the Secretary of Agriculture to inspect the books of contract markets and other documents related to trading in futures. In short, although it establishes a form of Federal supervision over the exchanges, the Commodity Exchange Act does not seek to transfer any of their essential functions to the Government. On the contrary, it preserves the Board as an essentially self-regulating body.

This is our present situation. Margins today are fixed by the Board, as they should be. Margin changes may have to be effected quickly due to the volatile nature of the business. Our own Board meetings can be called upon very short notice with changes to be effective upon the opening of the next day's trade, so interference with marketing functions is held to a minimum.

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Changes are made by experts representing many facets of the business. Their primary interest is efficient market functioning, inextricably tied to the public interest.

An elaborate set of rules and regulations under jurisdiction of the Board, augmented by constant surveillance of the Business Conduct Committee, imposes restrictions on the members that are more severe than those imposed by the Commodity Exchange Act. Self-regulation, under limited government supervision, is a reality.

A most interesting recent example of the present relationship of the Board of Trade to the Federal Government is found in the events surrounding the so-called DeAngelis affair, with which many of you may be familiar.

To tell the whole story in detail would take much too long, so let me get right to the essentials. On November 19, 1963, a firm called the Allied Crude Vegetable Oil Refining Corporation went bankrupt, causing extensive losses to certain brokers, banks and commodity dealers.

At first, some cries for further regulation of the commodity exchanges were heard. This died down, however, when it became apparent that the case involved basically the use of fraudulent warehouse receipts. These had been issued by warehouses that were neither supervised by any regulated commodity exchange nor licensed by the federal government. Rigid supervision by such competent authority could help prevent recurrence of this type of fraud.

In my own opinion, the Chicago Board of Trade should be congratulated, not criticized, for its role in this case. We feel the effectiveness of its regulations and of the broad, steady market it provides was demonstrated on November 20, 1963, when we were able to liquidate 7,000 soybean oil futures contracts within 20 minutes. And soybean oil futures prices ended on the upside for the day.
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Parenthetically, I should note that in the year of our best soybean oil trade, we averaged about 2,000 contracts per day. And I might mention that one contract is for 60,000 pounds of oil, worth approximately 71/2 cents a pound on that November 20. You're free to compute the amount of capital brought to bear on a major problem in that 20 minute period.

Despite the fact that our policies then in effect resulted in no losses to any commodity customer on this Exchange, other than through normal market action, we felt a review was in order. Within the few months after this situation, these steps were taken to help prevent a recurrence:

1. Daily price trading limits for crude soybean oil, cottonseed oil and soybean meal were amended.

2. Position limits were imposed for the same three commodities.

3. Rules of the Exchange were amended to require a member of the Association to register a membership for a firm within which he is a partner, officer, director or substantial stockholder unless a membership has been registered for the firm.

While officers of the Allied Crude Vegetable Oil and Refining Company were Exchange members as individuals, the firm had never been registered. Consequently, we had no jurisdiction over this non-member corporation and no authority to require it to submit financial information.

4. Rules were amended to provide that a member firm be required to arrange immediately for a transfer of open positions to another firm designated by the customer when financial difficulties arise that make it impossible for a firm to carry on business.

5. Rules were amended to provide the Business Conduct Committee with additional jurisdiction over finances of a clearing member and his non-clearing member customers.

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6. A regulation was adopted to prohibit futures commission merchants from accepting warehouse receipts owned by a customer as collateral, unless the receipts were eligible for delivery at a contract market.

In addition, increases were made in bonding requirements for soybean meal shippers regular for delivery on futures contracts. Soybean oil receipts and soybean meal certificates were redesigned, and registration procedures were tightened.

Today the Federal Government recognizes the vital role of the futures market in our economy, and seeks to maintain supervisory authority over self-regulation of the market to insure the protection of the public interest. Similarly, the public, enlightened by men and women such as yourselves, has come to realize that the futures market functions in the public interest and that futures trading is an essential part of the complex mechanism which is the free commodities market.

Just as public opinion has matured over the past century, so has the Board of Trade recognized its responsibility to the people as a whole to provide the valuable services of a commodities exchange while guarding against manipulation and fraud. We shall continue to recognize these responsibilities in the future by providing even stronger leadership to the Board, and even more well-defined supervision over the activities of its members.

As you know, I am now serving my third term as Chairman of the Board of this Exchange. The closing thought in my address to our membership at the annual meeting in January might make a fitting close today:

"There are those who mistakenly consider freedom to be synonymous with license. I am not one, as I view freedom as being directly tied to responsibility. I feel the more responsibility that is self imposed, the less the restraint that will have
to be imposed by outside forces. Therefore, it would appear that self-discipline is essential."

It is my hope that, for now and for the future, the administration of the Chicago Board of Trade will continue to be dedicated to that policy.

Thank you.

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DISCUSSION

CHAIRMAN KNOKE: Thank you very much, Mr. Carey for this interesting and informative paper. I wonder if your busy schedule would permit us to have a few questions.

CAREY: Certainly.

KNOKE: One of the questions that we asked all the other speakers this morning is something to which you alluded. You suggested, I think, that if we have no speculation, we will have no futures market. A question that has been asked in reverse before is "If we have no hedging, would we have a futures market?" Would you care to talk on this?

CAREY: If we would have no hedging? Well, it is the necessity of hedging which brings about the necessity for the futures market, and, hence, speculation. The price risk exists first. Then, the desire to reduce the price risk as much as possible, an insurance medium, brings about the existence of, or the necessity for, a futures market.

The necessity for the futures market again entails the necessity for speculators to absorb the risks involved in the working of a futures market.

BAKKEN: In my paper I pointed out that the Japanese had traded for one hundred seventy-two years without hedging, and that the Board of Trade here had also traded from 1867 to the '80's without hedging. How would you explain that phenomenon?
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CAREY: Well, I guess we didn't have airplanes then either, but that wouldn't mean that wouldn't have been a good thing. In other words, I think hedging has proved its economic purpose, and as long as it is well handled through a regulated exchange such as this, then, it is helpful to all concerned from producer to consumer.

MUTTI: Do you think position limits have pretty well accomplished what they were set out to do in terms of amount of trades that one person can consummate in a given day or how much total position he can take?

Would you comment on position limits and whether you feel they should actually be different in one commodity from another? Should they have any relation to the total amount of trading, for example?

CAREY: Yes, I definitely think position limits should be governed by the commodity involved. For instance, in rye, our limit is five hundred thousand bushels, but for all other kinds of grain, it is two million. The two million limit in soybeans, for example, has been in existence for about twelve years, I think. Twelve years ago, the crop was one-third of what it is.

We have tried repeatedly to get this position limit increased, but without success. It just makes sense if the position limit was two million with a crop one-third of today's crop, the necessity to provide more flexibility to the speculator has also increased along with the size of the crop.

MUTTI: What kind of arguments and logic do you run against, then, when you try to get the limits raised? What are the objections you encounter in this case?

CAREY: I can't understand their logic at all. They think that two million is enough for any one person. For instance, we are limited to that in our daily volume of trading. That's the last thing we try to get increased. See, we are oftentimes
trading a hundred million bushels plus in beans in a day, and some of the big spreading type speculators can run out their two million bushel limit by ten o'clock. They have to quit trading for the day, and I think this robs the market of a certain amount of liquidity that should be there.

PHILLIPS: What supervision does the Board exercise over the people that are on the floor actually buying and selling?

CAREY: We have a Floor Practices Committee that pertains to the mechanics of trading itself. We also have a Business Conduct Committee dealing with other aspects of floor traders, so, then, I would say, basically, we have two committees that are in charge of the regulation of floor traders.

MUTTI: Could you distinguish a little bit between what type of questions are referred to each of these committees?

CAREY: For instance, a question which might come to the Floor Practices Committee might go something like this, "A customer claims that May beans sold at $2.90 at 11:13 a.m. on the morning of April twenty-ninth. He had an order to buy May beans at $2.90. This order was unfilled."

Obviously, it should have been filled if the market sold at $2.90, he should have had his beans at $2.90. What to do? All right. We refer it to the Floor Practices Committee. They, in turn, refer to the record of quotations and the times. Then, we get the specific broker involved.

It may be one of several things. Maybe the broker forgot he had the order. Maybe he didn't see it sell at $2.90. He didn't know it was $2.90 offered or several other things of that type.

The Floor Practices Committee decides if the broker was at fault and how much the adjustment should be.

The Business Conduct Committee might handle such things as activities in a current future where manipulation is suspected. It might call in a certain individual or a house to
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explain just why and for what purpose they are holding some cash beans and some futures beans. Depending on the nature of the situation, the committee might tell them to do one thing or another, but manipulation, for example, is in the province of the Business Conduct Committee. The Committee maintains surveillance of financial requirements, too.

DIETZ: How do you decide who obtains a membership and is able to trade on the floor?

CAREY: That is handled by the Membership Committee. They have an investigation and a prospect appears before them. They either recommend or don't recommend — they bring it up to the Board, and, then, the Board votes on the proposal.

All that is required is that you're twenty-one years old, male and have financial and other good character.

HARDIN: I wonder, what is the penalty for violation of these regulations.

CAREY: It varies. It varies according to the seriousness of the particular offense, from reprimand through expulsion.

WILT: What type of financial backing would be required other than buying the initial membership.

CAREY: It would depend a lot on what you intended to use the membership for. If you are going to be a phone man in the employ of a commission house, or if you are going to be a cash grain dealer in the employ of a cash grain house, it would be considerably less than if you were going to be a floor trader, and, this, again, varies with the purpose for which you use your membership.

WILT: What might be some representative figures, say, just taking the most financial backing you would want everybody to put up?

CAREY: I haven't been on the Membership Committee for a number of years, but I think they would require a floor
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trader to have about ten thousand dollars above and beyond the price of membership.

ARTHUR: What categories of the people we saw downstairs this morning are bonded, and for how much?

CAREY: I wouldn't have any statistics on the number who are bonded. I presume that all of the large firms bond their employees, but, again, that is company policy. It isn't Board policy.

ARTHUR: The Exchange doesn't require there be a bonding surety?

CAREY: In the case of a member who doesn't have the financial requirements for membership, for instance, it is permitted that two other members guarantee this individual, but in the case of the bond, it is an individual company policy, and the Board does not speak out on this point.

EHRICH: Are these position limits to the individual trader? Could a company take a position with respect to twelve employees on the floor?

CAREY: The position limit applies only to speculators and not to hedging. As a speculator, I have the position limit imposed on me. I could not "borrow" from another member and double them up.

GOLDBERG: Getting back to the DeAngelis affair and the Business Conduct Committee—I think everybody in the room couldn't agree more with you that self regulation is better than regulation being imposed by outside forces that will hamstring the use of the futures market, but I can imagine there must be a conflict of interests at times. It must be awfully difficult for a group of men as unbiased as I am sure the Business Conduct Committee is. Take the DeAngelis affair. Here is a man who is so involved in one major marketing segment, involved in so many different firms' activities, involved in so much commission handling and everything else
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that goes with a large volume trade activity, that the pressures on these people must have been enormous when they have to sit in judgment on one of their best customers.

So, you rose to the occasion — but how do you rise to the occasion, how do you meet these types of pressures?

CAREY: I would just say this: If we can't meet the test, then we are not worthy of the privilege and it is going to be taken away from us. Up to now, I think it has been proved that we were able to meet the situations.

DIETZ: I seem to feel a distinction between about three kinds of memberships that you can have, one to sit on the telephone, another to be in the pit, and another one on the cash table, is that right?

CAREY: No.

DIETZ: Do these people interchange themselves?

CAREY: We only have one type of membership. You can use it for a number of different purposes.

THORESON: How do you handle a situation such as this recent erroneous soybean report from the U.S.D.A.?

CAREY: We can't. After all, that is in the government realm, and we really can't do much about it except protest, send them a letter or protest that their procedure certainly lacked something. (Laughter)

DAVIS: This morning Mr. Powers from Hutton & Company said that if a firm had orders, for example, to buy a hundred thousand May wheat and orders likewise to sell a hundred thousand May wheat, that they couldn't cross them, that this is against the rules.

Now, couldn't they cross them on the Board at — let's say the market was $1.65\frac{3}{4}$ asked for May and $1.65\frac{1}{2}$ bid — couldn't they cross them at $1.65\frac{5}{8}$?

CAREY: No, both trades have to be executed competitively in the pit.
DAVIS: I see. What is the reasoning here?

CAREY: Well, I think basically if they are not executed competitively in the pit, all the market influences which should be present for a true competitive market just aren't going to be there.

This is one thing we and the C.E.A. are very strong about, competitive execution of all orders.

ULLMAN: Suppose that the same broker has a large quantity of rye to sell and a large quantity of rye to buy at the same time with no activity in the pit. How would that be handled?

CAREY: In some instances, there might be a penalty. I mean, you might not be able to execute them at the same price. In a broad market, yes. Oftentimes, like the corn market of today, you are able to buy and sell a three or four million bushels of corn at one price. The rye market of today has a thin open interest. You wouldn't be able to complete the transaction.

SCHRUBEN: What I interpret you are saying is that a broker must always deal with someone from some other firm. He cannot deal with himself or with another man from his same firm.

CAREY: No, he can deal with another man from the same firm, but he cannot deal with himself. He is not allowed to cross the orders himself.

DAVIS: If there were two members of that firm on the floor, each could take a side and trade with each other?

CAREY: As long as they did it competitively, yes.

ARTHUR: How many men actually can trade from one membership? A single member? Can he have several traders on the floor?

CAREY: Just himself.

ARTHUR: If he has one membership, and he is very busy
in the soybean market, and he has some orders to fill in corn, does he delegate those?

CAREY: Sure, to a broker who will fill these orders for him.

ARTHUR: He delegates orders? That could be done in your cross-trading, too, could it not?

DAVIS: If he gives up the order, he has to pay a commission to the other broker.

CAREY: He has to pay a brokerage fee, yes. He couldn't be the principal on both sides to buy and sell at the same price. And the trade must be made competitively in the pit.