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FUTURES MARKETS

Preliminary Information Related to a Futures Transaction Fee

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The Honorable Patrick J. Leahy
Chairman, Committee on Agriculture, Nutrition, and Forestry
United States Senate

The Honorable E (Kika) de la Garza
Chairman, Committee on Agriculture
House of Representatives

As mandated by the Futures Trading Practices Act of 1992, we began studying the feasibility of funding the Commodity Futures Trading Commission (CFTC) through a futures[1] transaction fee. Shortly after we began our study, the administration proposed instituting a fee on all U.S. futures transactions to cover CFTC's costs. Because the Committees will be considering the transaction fee proposal before we can complete our study, we agreed with the Committees to provide preliminary information on the fees charged by (1) federal regulators of financial markets and institutions, (2) futures and securities exchanges, and (3) foreign countries that account for the majority of global futures trading volume. This report provides the agreed-upon information and discusses the usefulness and limitations of the information.

Background

The administration's proposed transaction fee on U.S. futures markets would be imposed on the purchase and sale of a futures contract, called a round-turn transaction, and would also apply to options[2] on futures contracts. The Office of Management and Budget estimated that the proposed $0.14 round-turn transaction fee would generate revenue of $55 million in fiscal year 1994 and revenue of $235 million from fiscal years 1994 through 1997—enough to cover CFTC's costs.

The U.S. futures industry is concerned that the proposed transaction fee will adversely affect the competitiveness of the domestic futures markets, which have been facing increased competition from foreign futures markets as well as from domestic and foreign off-exchange markets. While U.S. futures trading volume generally increased every year between 1984

[1]Futures are contractual agreements to buy or sell a specific quantity and quality of a commodity at a specified price in the future. They enable futures market users, which include producers, processors, and institutional investors, to better manage their risk by transferring it to those more willing to bear it.

[2]Options give the buyer the right—but not the obligation—to buy or sell a specified quantity of a stock, commodity, or financial instrument at a fixed price within a specified time period.

and 1992, the U.S. share of world futures trading volume decreased 35 percent—from 82 percent to 47 percent—during this period.

Results in Brief

CFTC, the Securities and Exchange Commission (SEC), the Farm Credit Administration,[3] and bank regulators collect fees and/or assessments from the industries they regulate. For fiscal years 1987 through 1991, CFTC fees amounted to less than 5 percent of its appropriations. During the same period, SEC fees amounted to more than 130 percent of its appropriations. The other federal regulators we reviewed are self-funded agencies; their operating expenses were funded entirely by fees and assessments, as well as by income earned on investments.

The futures and securities exchanges that we reviewed impose transaction fees and other charges to fund their operations. The type and amount of fees and other charges differ both within and among the exchanges. Data provided by the futures exchanges and the National Futures Association[4] indicate that the total fees imposed on each round-turn futures transaction range from $1.34 to $2.94 for public customers and from $0.14 to $0.60 for floor traders.[5] In addition to these fees, public customers and floor traders pay other nonexchange transaction fees and charges.

Of the top four countries in terms of global futures and options trading volume—the United States, the United Kingdom, Japan, and France—Japan is the only country that imposes a specific futures transaction fee. However, the United Kingdom and France collect other exchange-related fees or taxes to fund their regulatory costs.

The information that we provide is useful in comparing the extent to which CFTC and other federal regulators are funded, directly or indirectly, by the industries they regulate and in comparing the proposed transaction fee with fees imposed by futures exchanges and the National Futures Association. However, the information has limited usefulness in assessing the potential impact of the proposed fee on the competitiveness of U.S. markets. This is because futures traders and other market users base their trading decisions—whether to trade at U.S. futures exchanges, foreign futures exchanges, or off-exchange markets—not only on the fees imposed

[3]The Farm Credit Administration is an independent agency that oversees the Farm Credit System—a nationwide system of borrower-owned financial institutions organized as cooperatives.

[4]The National Futures Association is a self-regulatory organization that is responsible, under CFTC oversight, for regulating certain aspects of the futures industry.

[5]Floor traders trade for themselves on the exchange floor.

by federal regulators and exchanges, but also on other factors affecting their total trading cost and profitability, such as exchange operating hours and market liquidity.

Objectives, Scope, and Methodology

The objectives of our work were to provide information on the fees charged by

- CFTC, SEC, the Farm Credit Administration, and federal bank regulators—which include the Federal Deposit Insurance Corporation, Federal Reserve System, Office of the Comptroller of the Currency, and Office of Thrift Supervision;
- futures and securities exchanges, including the Chicago Board of Trade, Chicago Mercantile Exchange, New York Mercantile Exchange, New York Stock Exchange, and Chicago Board Options Exchange; and
- foreign countries that account for the majority of global futures trading volume.

To meet our objectives, we interviewed officials of and obtained information from CFTC, SEC, the Farm Credit Administration, federal bank regulatory agencies, futures and securities exchanges, the National Futures Association, and the Futures Industry Association.[6] We also contacted six futures industry firms that we judgmentally selected because they represented different segments of the industry. The information provided is preliminary. Also, we did not verify the accuracy of the exchange-provided data. We did our field work in Chicago, New York, and Washington, D.C., between February and May 1993.

Federal Regulators of Financial Institutions and Markets Impose Fees and Assessments

CFTC, SEC, the Farm Credit Administration, and federal bank regulators collect fees and other charges from the industries they regulate. CFTC and SEC are funded through congressional appropriations, but they collect fees, among other reasons, to recover their cost of providing certain services and performing certain activities for their regulated industries (see app. I). CFTC and SEC fees are generally deposited in the U.S. Treasury as general revenue. For fiscal years 1987 through 1991, CFTC's appropriated funding increased from about $30 million to $44 million, and its fees amounted to less than 5 percent of its appropriations. During the same period, SEC's appropriated funding increased from about $115 million to $189 million, and its fees amounted to more than 130 percent of its appropriations (see app. II). Futures market users also fund the National Futures Association.

[6]The Futures Industry Association is the national trade association of the futures industry.

In 1992, they paid the association $25.3 million. Securities market users fund the National Association of Securities Dealers.[7] Because a part of the funds that market users pay to the National Association of Securities Dealers is used to operate a segment of the stock market, the association's budget is not entirely comparable with the National Futures Association budget.

Unlike CFTC and SEC, the Farm Credit Administration and federal bank regulators are self-funded agencies and, as such, do not receive congressional appropriations. In 1991, the Farm Credit Administration's regulated institutions paid about $40 million to cover the agency's operating expenses. Federal bank regulators' operations were also financed through fees and assessments, as well as through income earned on investments. The Federal Deposit Insurance Corporation's insured depository institutions paid the agency's 1991 operating expenses of $284 million through assessments. Institutions that use the Federal Reserve System's banking-related services paid almost 50 percent of the agency's 1991 operating expenses of $1.6 billion through fees. The Office of the Comptroller of the Currency's regulated institutions paid about 95 percent of the agency's 1991 operating expenses of $294 million through fees and assessments. The thrift industry paid over 95 percent of the Office of Thrift Supervision's 1991 operating expenses of $230 million through fees and assessments.

Futures and Securities Exchanges Impose Fees, Dues, and Other Charges

The futures and securities exchanges impose fees, dues, and other charges to fund their operating costs. Some exchanges charge annual membership dues, but all the exchanges and the associated clearinghouses[8] that we reviewed charge transaction and clearing fees. In addition to exchange transaction and clearing fees, futures and securities exchange members and other market users incur other transaction-related and fixed costs. For example, public customers incur nonexchange transaction fees and brokerage commissions, while traders incur the cost of overhead and of buying or leasing an exchange membership. The transaction costs we present do not include all transaction-related costs or any fixed costs.

[7]The National Association of Securities Dealers is a self-regulatory organization whose functions include assisting SEC in regulating the securities industry. It also operates an automated stock market, where securities transactions are negotiated and executed through competing dealers operating by telephone and through computer networks.

[8]Clearinghouses match and verify trades as well as guarantee the performance of each contract. Exchanges charge the clearing fee when the clearinghouse is a division of the exchange; the clearinghouse charges the fee when it is a separate corporation.

Cost of Trading at Futures Exchanges

Data provided by the Chicago Board of Trade, Chicago Mercantile Exchange, and New York Mercantile Exchange indicate that exchange transaction and clearing fees are generally highest for public customers and lowest for floor traders. For a public customer, the round-turn futures transaction cost ranges from $1.34 to $2.94, depending on the exchange. This estimate includes the National Futures Association's $0.24 futures transaction fee, which is assessed on all public trades. The association and the Chicago Mercantile Exchange, unlike the other exchanges, charge public customers lower fees to trade options on futures than to trade futures—the association charges a $0.14 round-turn transaction fee and the exchange charges a $0.70 round-turn clearing fee. For a floor trader, the round-turn futures transaction cost ranges from $0.14 to $0.60, depending on the exchange. (See app. III for additional information.)

The U.S. futures exchanges that we reviewed charge a transaction and/or clearing fee for each contract traded. However, these fees vary both among and within exchanges, depending largely on whether the trade is for a public customer or an exchange member. For example, the New York Mercantile Exchange charges a $1.00 round-turn transaction fee for customer trades, but it does not charge a transaction fee to exchange members trading for themselves. The Chicago Board of Trade charges a $1.00 round-turn transaction fee for customer trades and a $0.04 round-turn transaction fee to members trading for themselves.

In addition to the exchange transaction and clearing fees, public customers and floor traders pay other fees that are assessed on each transaction. Public customers place their orders through futures commission merchants[9] that execute these orders for a commission. Public customers also pay the National Futures Association's transaction fee. Floor traders that are not clearinghouse members pay a fee to such members to have their trades cleared. A clearinghouse member told us that it charges floor traders about $1.90 per round-turn to clear their trades.

The Chicago Mercantile Exchange also collects annual membership dues but the Chicago Board of Trade and New York Mercantile Exchange do not. In 1992, the Chicago Mercantile Exchange's annual membership dues were $50.00. All these exchanges collect fees for providing information on contract prices as well as for providing equipment and communication services to members.

[9]Futures commission merchants are firms that buy or sell futures contracts and accept payment from or extend credit to those whose orders they accept.

If the administration's transaction fee is implemented, the Chicago Mercantile Exchange and Chicago Board of Trade estimate that their typical floor traders will pay about $6,000 and $8,400, respectively, in additional fees each year. The Chicago Board of Trade estimates the fee would increase traders' total transaction costs anywhere from about 7 percent to 39 percent, depending on their trading volume. The exchanges did not estimate what the fee would cost futures commission merchants or floor brokers.

Cost of Trading at Securities Exchanges

Like the futures exchanges, the securities exchanges and clearinghouses charge transaction and clearing fees. The securities exchanges pass through to market users the SEC transaction fee, which is assessed when stock is sold.

New York Stock Exchange

Fees charged to buy or sell securities at the New York Stock Exchange include an exchange transaction fee, a clearing fee, and the SEC transaction fee. The cost to buy and sell securities depends on, among other things, whether the transaction is for a public customer or a member and how many shares are being bought or sold. For example, for a customer to buy 1,000 shares, the transaction cost would range from $3.08 to $4.68. This range excludes the brokerage commission and specialist[10] fee that market users may incur.

The New York Stock Exchange's transaction fee is assessed on each share of stock that is bought or sold, applies only to customer trades, and is capped at $80.00 per transaction. The transaction fee is $0.00265 per share for the first 5,000 shares purchased and $0.00010 for additional shares purchased, up to the cap. The exchange provides up to $1.60 in transaction-fee credits on each order of 100 to 2,099 shares that is routed through the exchange's computer system. The exchange passes through the SEC transaction fee, which is assessed when securities are sold, and is set at 1/300 of 1 percent of sale value. This rate produces about a $0.33 fee on the sale of $10,000 of securities.

Chicago Board Options Exchange

Fees charged to trade stock options and stock-index options at the Chicago Board Options Exchange include an exchange transaction fee and a clearing fee. The exchange transaction fee depends on, among other things, whether the options contract is based on an individual stock or a stock index and whether the trade is for a member, public customer, or

[10]Specialists are exchange members who are responsible for maintaining an orderly market in exchange-assigned stocks by trading from their own accounts to offset temporary imbalances in supply and demand for those stocks.

market maker.[11] For a member, the round-turn transaction cost ranges from $0.46 to $0.54, depending on whether the option is based on a stock or stock index. For a customer, the round-turn transaction cost ranges from $0.58 to $1.58, depending on whether the option is based on a stock or stock index and whether the trade was executed by a floor broker or through the exchange's computer system. For a market maker, the round-turn transaction cost ranges from $0.38 to $0.42, depending on whether the option is based on a stock or stock index. These cost ranges exclude the SEC transaction fee and any brokerage commissions. (See app. IV for an example of fees assessed on an options contract.)

Three of the 10 Countries With the Greatest Futures and Options Volume Impose Transaction Fees or Other Charges

According to Futures Industry Association data, 10 countries accounted for about 98 percent of world futures and options trading volume in 1992.[12] Of these, the United States, United Kingdom, Japan, and France accounted for about 80 percent of global futures and options trading volume. The United States accounted for 47 percent of the world trading volume, followed by the United Kingdom at 14 percent, Japan at 12 percent, and France at 8 percent. (See app. V for additional information.) Brazil, Germany, Australia, Sweden, Singapore, and Switzerland accounted for the remaining volume.

Japan is the only one of these 10 countries that imposes a specific transaction fee. However, the United Kingdom and France collect other fees or taxes that are designed to cover their regulatory costs. Japan taxes certain futures transactions. The tax rate for a round-turn transaction, with some exceptions, is 0.002 percent of the value of the futures contract—that is, 0.002 percent of the contract price multiplied by its size. The United Kingdom collects fees from exchanges and clearinghouses that are designed to cover its regulatory costs. France collects a tax from its exchanges that is paid to the exchange by members. The tax is not levied when the broker or customer is not a resident of France or a European Economic Community country.

[11] A market maker is an exchange member who executes transactions on the exchange floor for exchange-assigned options. A market maker is obligated to buy when excess sell orders exist and sell when excess buy orders exist.

[12] U.S. volume statistics include only futures and options on futures. Foreign volume statistics include futures, options on futures, index options, and securities options.

The Information Provided Has Limited Usefulness

The preliminary information that we provide is useful in comparing the extent to which federal regulators of financial institutions and markets are funded by the industries they regulate and in comparing the proposed transaction fee with the fees imposed by the futures exchanges and the National Futures Association. However, this information has limited usefulness in assessing the potential impact of a transaction fee on the competitiveness of U.S. markets. Whether a transaction fee will cause traders and other market users to transfer their business to other domestic off-exchange or foreign markets depends partly on how profitable such markets are to traders and how costly such markets are to other market users relative to the U.S. futures markets. Officials of futures industry firms that we contacted said that market liquidity and exchange operating hours are also major factors affecting their decision on where to trade. Due to time and data constraints, we did not obtain information on trading profitability or market liquidity. Also, the information that we present on fees charged by various exchanges and countries represents only some of the trading costs that traders and other market users incur. Finally, we do not present any information on the off-exchange competition that U.S. futures markets face, but we will address this topic in a forthcoming report on derivative products.[13]

Agency Comments

We obtained informal comments from CFTC and futures exchange officials. They provided technical clarifications that we incorporated where appropriate.

We are sending copies of this report to CFTC and other interested parties. We will also provide copies to others upon request.

[13]Derivative products are financial instruments whose value depends on that of another asset, index, rate, or commodity. Futures and options are examples of derivative products.

The major contributors to this report are listed in appendix VI. Please contact me at (202) 512-8678 or Cecile O. Trop, Assistant Director, at (312) 220-7600 if you have any questions.

James L. Bothwell

James L. Bothwell
Director, Financial Institutions
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Contents

Abbreviations

CFTC	Commodity Futures Trading Commission
SEC	Securities and Exchange Commission

Fees, Assessments, and Other Charges of Financial Markets and Institutions Regulators

Agency	Regulatory role	Fees, assessments, and other charges
CFTC	Oversees the futures industry and its self-regulatory organizations.	User fees: Futures exchanges largely pay the fees, which are designed to cover CFTC's cost of providing certain services and performing certain activities required under the Commodity Exchange Act.
SEC	Oversees the securities industry and its self-regulatory organizations.	Securities registration fee: Registrants pay the fee, which is designed to cover SEC's processing costs.
		Securities transaction fee: Securities exchanges pay the fee.
		Tender offer and merger filing fees: Applicants submitting the filing pay the fee.
		User fees: Individuals and businesses receiving the benefits pay the fee, which is designed to cover SEC's cost of providing certain services and performing certain activities required under the SEC-administered statutes.
Farm Credit Administration	Supervises, examines, and regulates the activities of the Farm Credit System.	Assessment: Banks, associations, and other system entities pay assessments, which cover the regulator's administrative costs.
Federal Deposit Insurance Corporation	Serves as the primary regulator of state-chartered banks that are not members of the Federal Reserve System.	Assessment: Insured depository institutions pay an assessment based on their deposits, which covers the regulator's operating costs.
Federal Reserve System	Regulates all bank holding companies, supervises state-chartered banks that are members of the Federal Reserve System, and regulates the foreign activities of U.S. banks and the U.S. activities of foreign banks.	Service fees: Institutions pay fees for certain banking-related services, which cover the agency's cost of providing the services.
Office of the Comptroller of the Currency	Supervises all national banks.[a]	Assessments: National banks pay asset-based assessments, which cover the regulator's supervisory costs.
		Examination fees: National banks pay hourly examination fees that are not recovered through the general assessment.
		Corporate fees: National banks and prospective national banks pay application fees to cover the cost of processing the applications and other filings.
Office of Thrift Supervision	Serves as the primary regulator for thrifts and thrift holding companies.	Assessment: Thrifts pay an asset-based assessment, which covers the regulator's examination and supervisory costs.
		Examination fees: Thrift holding companies pay the fee, which covers the regulator's cost of examining them.
		Application fees: Applicants pay the fee, which covers the regulator's cost of processing the various applications, filings, notices, and requests.

[a]National banks are commercial banks that are chartered by the federal government.

Sources: Agencies listed above.

CFTC and SEC Funding, Fee Revenue, and Fee Revenue as a Percent of Funding for Fiscal Years 1987 Through 1991

	CFTC			SEC		
Fiscal year	**Funding (in millions)**	**Fee revenue (in millions)**	**Fee revenue as a % of funding**	**Funding (in millions)**	**Fee revenue (in millions)**	**Fee revenue as a % of funding**
1987	$29.8	$1.02	3.4	$115	$264	230
1988	32.8	1.03	3.1	135	249	184
1989	34.7	1.09	3.1	143	214	150
1990	39.2	1.68	4.3	167	232	139
1991	44.0	1.83	4.2	189[a]	259	137
Totals	**180.5**	**6.65**		**749**	**1,218**	

[a]The 1991 total excludes the unobligated balance of $8,264,520, which is available until expended.

Sources: CFTC and SEC.

Fees the Chicago Board of Trade, Chicago Mercantile Exchange, New York Mercantile Exchange, and National Futures Association Assess on a Round-Turn Transaction

	Chicago Board of Trade		Chicago Mercantile Exchange			New York Mercantile Exchange	
Fee	**Public customer**	**All floor traders**	**Public customer**	**Member floor trader**	**Lessee floor trader**	**Public customer**	**All floor traders**
Exchange transaction fee	$1.00	$0.04[a]	[b]	[b]	[b]	$1.00	$0.00
Clearing fee	0.10	0.10	$1.40	$0.14	$0.60	1.70	$0.30[c]
National Futures Association transaction fee	0.24	[b]	0.24	[b]	[b]	0.24	[b]
Total cost	**$1.34**	**$0.14**	**$1.64**	**$0.14**	**$0.60**	**$2.94**	**$0.30**

[a]Chicago Board of Trade floor traders who lease a seat pay higher exchange transaction fees after the first year of the lease.

[b]Not applicable.

[c]New York Mercantile Exchange members pay clearing fees of $0.80 for round-turn transactions not completed during the same trading session.

Source: Exchanges listed above.

Fees the Chicago Board Options Exchange Assesses on a Round-Turn Standard & Poor's 100[a] Index Option Transaction

Fee	Public customer trading through: A broker on the trading floor	Public customer trading through: The computer execution system	Market maker
Exchange transaction fee[b]	$0.80	$0.80	$0.12
Clearing fee	0.20	0.20	0.20
Trade match fee	0.08	0.08	0.08
Floor brokerage fee[c]	0.06	d	d
Computer execution system fee[e]	d	0.50	d
Total cost	**$1.14**	**$1.58**	**$0.40**

[a]The Standard & Poor's 100 stock index is based on 100 stocks from diverse industry groups.

[b]Exchange transaction fees charged to public customers are based on the price of the option traded. The data shown above are for an option priced at $1.00 or more. If the price is less than $1.00, the fee is $0.40.

[c]Market makers do not pay floor brokerage fees for transactions they execute for themselves. Market makers that execute transactions through a floor broker pay the floor brokerage fee of $0.06 per round-turn options contract. In addition, floor brokerage fees do not apply to public customer transactions executed through the exchange's computer execution system.

[d]Not applicable.

[e]Brokers may execute public customer orders for fewer than 11 contracts through the exchange's computer execution system. The exchange charges a fee only on stock-index option orders executed through this system.

Source: The Chicago Board Options Exchange.

Information on the Four Countries Trading the Highest Volume of Futures and Options[a] Contracts

	Regulatory agencies	Funding method	Tax on futures (yes/no)	1992 trade volume[b]	Competing products[c]
United States	CFTC	General tax revenues[d]	No	364,536,807 (47)	Eurodollars, T-Bonds, metals, currencies, foreign stock indexes, petroleum, feedstuffs, soft commodities.[e]
United Kingdom	Securities and Investments Board	Fees charged to exchanges and clearinghouses	No	110,398,032 (14)	Eurodollars, T-Bonds, currencies, metals, euromarks, FT-SE 100,[f] petroleum.
Japan	Ministry of Finance Ministry of International Trade Ministry of Agriculture, Forestry, and Fisheries	General tax revenues[g]	Yes[h]	94,403,064 (12)	Currencies, euroyen, metals, feedstuffs, Nikkei, soft commodities.[e]
France	Commission des Operations de Bourse	Fees imposed on the issuance of securities, bonds, and take-over bids and annual fees assessed on mutual funds. No fees exist on futures transactions. However, all exchanges collect an 18.6 percent sales tax on clearing fees that is paid to the government.	No	59,192,515 (8)	No directly competing products.

[a]U.S. volume statistics include only futures and options on futures. Foreign volume statistics include futures, options on futures, index options, and securities options.

[b]Percent of world market share is noted in parentheses.

[c]Contracts shown are those listed on both U.S. and foreign exchanges.

[d]CFTC is funded by appropriations but collects user fees, which are deposited in the U.S. Treasury.

[e]Soft commodities include cocoa, sugar, coffee, and cotton.

[f]FT-SE 100 is the futures contract on the Financial Times-Stock Exchange index.

[g]Japan collects a transaction fee, which is designated as general revenue.

[h]The tax is .002 percent of the contract's round-turn value, based on the contract's price and size.

Sources: CFTC, the Chicago Mercantile Exchange, and the Futures Industry Association.

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