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A Futures Transaction Fee Is Administratively Feasible

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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 (P.L. 102-546), we are reporting on (1) the administrative feasibility of implementing a futures[1] transaction fee to fund the additional enforcement and market surveillance activities that the act assigns to the Commodity Futures Trading Commission (CFTC) and (2) the ability of such a fee to provide CFTC with more resources to oversee the futures markets.[2] We found that implementing a transaction fee is administratively feasible; however, such a fee may not provide CFTC with more resources to oversee the futures markets unless it is earmarked for CFTC's use.[3]

Background

Proposals to establish a futures transaction fee are not new. Past and present administrations, in their fiscal years 1991 through 1994 budgets, unsuccessfully proposed establishing a transaction fee on all futures contracts. Under these proposals, the fee would be (1) determined from estimates of future U.S. trading volume and CFTC funding needs, (2) assessed on each round-turn transaction (the purchase and sale of a futures contract), and (3) remitted by the exchanges. The fee was expected to generate sufficient revenue to cover the cost of all CFTC oversight activities—not just the additional CFTC enforcement and market surveillance activities specified in the 1992 act.

Objectives, Scope, and Methodology

To determine the administrative feasibility of implementing a futures transaction fee to fund additional CFTC oversight activities, we assumed

[1]Futures are contractual agreements to buy or sell a specific quantity and quality of a commodity at a specified price in the future.

[2]As discussed in Futures Markets: Preliminary Information Related to a Futures Transaction Fee (GAO/GGD-93-108, May 17, 1993), we could not determine the extent that a transaction fee would adversely affect the competitiveness of U.S. futures markets. As agreed with the Committees, we do not analyze the topic further in this report.

[3]An earmarked fee is dedicated by law for a specific purpose or program.

that the fee would be determined, assessed, and remitted in the same manner as in the administrations' transaction fee proposals. We did not address the mechanics of computing the costs of implementing the additional CFTC enforcement and market surveillance activities specified the act.[4] In doing our work, we interviewed CFTC officials and reviewed agency documents, including statutes and regulations. We also interviewed officials of three exchanges and their associated clearing organizations[5] and reviewed pertinent documentation that they provided We did our work at the Chicago Board of Trade, Chicago Mercantile Exchange, and New York Mercantile Exchange because these three exchanges accounted for about 90 percent of total U.S. trading volume in fiscal year 1992.

To determine whether a transaction fee would provide CFTC with more resources to oversee the futures markets, we discussed with CFTC and Securities Exchange Commission (SEC) officials the benefits that they ha received from their fee programs.[6] In addition, we reviewed GAO reports[7] and other material on implementing user fees and earmarking such fees.

We did our fieldwork in Chicago; New York; and Washington, D.C., between June and August 1993 in accordance with generally accepted government auditing standards.

Implementing a Futures Transaction Fee Is Administratively Feasible

Implementing a futures transaction fee to fund the additional CFTC oversight activities required by the 1992 act is administratively feasible. According to CFTC officials, the agency's cost of implementing the fee would be minimal if the exchanges collected the fee from their members and remitted it to CFTC. CFTC officials also said that to implement the fee, CFTC would need to promulgate a regulation defining a transaction and explaining how the fee would be administered. Once the regulation is enacted, CFTC would collect the transaction fee from the exchanges and ensure that each exchange's remittance was correct. CFTC already has

[4]According to a CFTC official, it would be difficult for CFTC to isolate the costs attributable to implementing the additional activities specified in the act.

[5]Clearing organizations are responsible for the daily clearance and settlement of all trades. Clearanc is the process of capturing the trade data, comparing the buyer's and seller's version of the data, anc guaranteeing that the trade will settle once the data are matched. Settlement is the process of fulfilli contract delivery requirements.

[6]As independent federal agencies, CFTC and SEC may impose user fees by regulation for a variety o administrative activities that benefit individuals and businesses.

[7]See GAO reports Budget Issues: Earmarking in the Federal Government (GAO/AFMD-90-8FS, Jan. [illegible] [illegible] Jan. 1993).

procedures to collect fees from the exchanges and deposit them in the U.S. Treasury under a current user fee program. To ensure the accuracy of each exchange's remittance, CFTC could use the trading volume data that the exchanges currently provide to compute expected transaction fees and compare these fees with actual exchange remittances. If needed, CFTC could periodically review the adequacy of exchange procedures for recording and reporting trading volume data.

The exchanges could implement a transaction fee by reprogramming their clearing organizations' data processing systems to assess the fee. The exchange clearing organizations already use these systems to assess clearing fees. Implementation costs would depend largely on the cost of reprogramming these systems to assess a transaction fee and the cost of filing the necessary forms to remit the fee to CFTC. However, without specific details regarding a transaction fee, exchange officials said that they could not determine how much it would cost to implement the fee. The officials identified several factors that could substantially increase implementation costs. These included requiring the exchanges to (1) audit members and take action against those not paying the fee, (2) vary the fee by type of market user,[8] and (3) complete extensive paperwork to remit the fee to CFTC.

A Futures Transaction Fee Would Not Necessarily Provide CFTC With More Resources

Whether a transaction fee would provide CFTC with more resources depends on whether the fee is deposited in the U.S. Treasury's general fund or earmarked for CFTC use. Unless the law specifically earmarks the transaction fee for CFTC use, fee collections would be deposited in the U.S. Treasury's general fund. Such funds would be available for appropriation by Congress and, therefore, would not directly provide CFTC with more resources. That is, CFTC would continue to receive its funding from Congress during the appropriations process. For example, in fiscal year 1988, SEC collected about $250 million in fees that were deposited in the U.S. Treasury's general fund. SEC, in turn, received about $143 million in appropriations from Congress.

A transaction fee could provide CFTC with more resources if it was earmarked to fund CFTC oversight activities. For example, SEC collects a securities registration fee, and, since fiscal year 1991, a portion of the fee has been earmarked to recover SEC's securities registration costs. Although earmarking has provided SEC with relatively stable funding, the former SEC

[8]Market users include public customers and floor traders, who are exchange members that trade for themselves.

Chairman recently testified that SEC's reliance on such funding concerns him because it puts the agency at financial risk if collections decline unexpectedly. Earmarking the transaction fee could provide CFTC with a relatively secure source of funding, provided that such a fee does not cause U.S. futures trading volume to decline and thereby reduce expected fee revenue. According to exchange officials, the fee would decrease trading volume by increasing trading costs, thereby reducing the competitiveness of the U.S. futures markets relative to foreign futures and off-exchange markets. Likewise, the former Acting CFTC Chairman recently testified that a transaction fee would have a negative impact on the futures industry, but he did not know how big the impact would be.

Agency Comments

We discussed the information contained in this report with CFTC and futures exchange officials. They generally agreed with our analysis and provided technical clarifications that we incorporated into this report where appropriate. The exchange officials reiterated their concern that a transaction fee could adversely affect the market.

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

The major contributors to this report were Cecile O. Trop, Assistant Director, and Richard S. Tsuhara, Evaluator-in-Charge. Please contact me at (202) 512-8678 if you have any questions concerning this report.

Helen H. Hsing

Helen H. Hsing
Associate Director, Financial
Institutions and Markets Issues

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