Futures contract not a credit transaction

There is no transfer of ownership in a futures contract—only an obligation to transfer ownership at a later date, through the clearing house, for full cash payment at the time of transfer—and this obligation is nearly always cancelled before a transfer occurs, by undertaking an opposite obligation vis-a-vis the clearing house. Thus a futures contract does not represent a credit transaction, in which ownership of an asset is transferred. The holder of a futures contract owns something of value insofar as he may be later entitled to receive a commodity of greater value, or to deliver a commodity of lesser value, than that agreed upon in the contract. He earns no right to the use or enjoyment of the commodity, or to income from it, so long as he holds the futures contract; nor does he earn such rights through the normal settlement of such contracts by offset. A contract entitling one to receive or deliver a commodity at exactly its market value has zero value, since by definition this can be done without such a contract. A futures contract has zero estimated value at the time it is entered into, in that the price agreed upon for the future transaction is the market's best current estimate, by definition, of what the value of the commodity will be at delivery time. In fact, the long time average value of the futures contracts actually bought and sold in the major grain markets does not differ significantly from zero; although any particular contract may take on positive or negative value.

Usually more than one half of all futures contracts outstanding are in the hands of hedgers, and of these substantially more than one half are sales contracts. In these instances the hedger owns a physical asset, changes in the value of which bear an orderly relationship to the value of his futures contract. If he should decide to deliver the physical commodity against the futures contract, full cash payment is required at the time of delivery, and this is the only transfer of ownership. Yet even this transfer of ownership in *satisfaction* of futures contracts is infrequent.

Margin deposits on futures contracts are in no sense down payments on credit transactions. The margin deposit is intended to represent full payment at all times for the value of the futures contract, which inheres in the uncertain, but statistically definable prospect of price change. This is the most important of several reasons why commodity futures margins differ from stock margins. Purchase of a stock certificate *does* transfer ownership, and the margin on such a purchase *is* a down payment on a credit transaction. It is because stock purchases on margin are *credit* transactions, and because it is deemed to be in the public interest to control the amount and kinds of credit, that authority to establish margins on stock purchases is vested in the Board of Governors of the Federal Reserve Banking System, and margin levels are much higher than those on commodity futures. The word "margin" has an entirely different meaning in the two contexts. If an analogy with stock trading is sought, a closer one exists in trading options to buy or sell stock at a later date. These so called "put" and "call" options bear the resemblance to commodity futures contracts that they do not transfer ownership; hence the payment made for them is not a down payment on a credit transaction. The prices of options to buy or sell stock at a later date are roughly comparable to margin levels on speculative transactions in commodity futures; i.e., about 10 per cent of the market value of the stock as compared to margins equalling about 10 per cent of the market value of the commodity described in a futures contract. Even though this similarity exists, the purpose of the payments differs in that no protection against insolvency of the holder of stock options is required. He has an option to buy if he chooses, whereas the holder of a futures contract has an *obligation* to buy (or sell), unless he offsets the obligation in the futures market. The purpose of margins on futures transactions is to guarantee this obligation.

A major reason for controlling credit purchases of stock is the concern to prevent such a stock market collapse as occurred in 1929, after stock prices had been carried to very high levels, partly through purchases made on short term credit.[1] There are two reasons, in addition to the fact that commodity futures transactions are not credit transactions, why a similar concern does not apply here. The first is that commodity futures transactions are absolutely symmetrical with respect to buying and selling, as stock transactions are not. In-

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[1] See the Supplementary Statement on Stock Margin Regulations attached at the end of this statement.