

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20540

OFFICE OF
COMMUNICATION

April 17, 1978

The Honorable Patrick J. Leahy
United States Senate
Washington, D. C. 20510

Dear Senator Leahy:

As you know, at the Subcommittee markup on S. 2391 last week there was some discussion of concerns which the SEC has raised with regard to jurisdiction over futures contracts on registered securities. Since this matter is scheduled to be considered further at the full Committee markup on Wednesday, you asked that a summary of the Commission's views be circulated to each member of the Committee, and this letter responds to that request.

In the past, the Commission has raised a number of questions regarding jurisdictional issues between it and the Commodity Futures Trading Commission ("CFTC"), and we previously suggested changes in the Commodity Exchange Act which would address these questions rather extensively. Subsequently, the General Accounting Office suggested a series of amendments which seem to be aimed at carving out a middle ground from among the positions of this Commission, the CFTC, and the Treasury Department.

However, the amendment now under consideration -- a copy of which is attached -- is far more modest and limited in scope than either our previous proposals, or those of the GAO. Its effect would be simply to make clear that this Commission has jurisdiction over any kind of risk management instrument which is derived from a security, or group of securities, which are required to be registered with our agency under existing law. I want to stress the point that this amendment does not touch in any way upon the issue of futures contracts on unregistered securities, such as Ginnie Mae's, Treasury bills, Treasury Notes, and commercial paper with a maturity date of less than 90 days.

This Commission now has full regulatory authority over registered securities, and over options on those securities. We believe that any futures contracts which might be traded on those securities would, in practice, be substantially indistinguishable from options on securities which we currently regulate. Both options on securities and futures on securities would trade at prices derived from the prices of the underlying security. Both could be used for hedging, or risk management purposes by holders of the underlying security. And both carry with them the potential to be used for manipulative purposes. The Commission feels very strongly that if we are to continue to do an effective job of discharging our responsibility to regulate the underlying securities markets, we must be able to regulate instruments which are derived from individual registered securities or from pools or indexes of such securities. The existing situation has the potential for split regulation, which would make it almost impossible to exercise effective surveillance of the markets.

I do want to point out that no futures contracts on registered securities have been designated as of this time, although a proposal to trade futures contracts on the Dow Jones Average of 30 registered securities is pending before the CFTC. Therefore, the statutory change which is now under consideration is aimed at preventing the development of what could be a very troublesome situation in the future. Because it does not involve existing futures contracts or established futures trading activity, this change could now be accomplished easily, with no adverse impact on the futures industry or on market participants.

The proposed amendment would simply add to the Commodity Exchange Act language specifying that the definition of "commodity" does not include any security registered under the Securities Act of 1933, or an index, or interest in a pool, composed of such securities. It would further make clear this Commission's regulatory authority over any agreements for future delivery of such securities, indexes, or interests in pools on such securities. Absent such authority as to indexes or interests in pools, the Commission's ability to enforce the Investment Company Act of 1940 will be questioned by those who seek to evade the strictures of federal law.

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This is a modest amendment with a very limited objective. Although it does not address many of our jurisdictional concerns, it would help clear up a situation which carries the potential for a serious future erosion of investor protection. Further, it would do so without in any way impinging upon existing trading patterns in the futures markets.

Your consideration of the Commission's views with regard to this matter will be very much appreciated. If I or the Commission's staff can provide additional information or be of assistance in any way, please do not hesitate to call on me, or have your staff contact our chief of Congressional liaison, Andrew Rothman, at 376-8093.

With best wishes.

Sincerely,

Harold M. Williams
Chairman

Enclosure