



OFFICE OF THE
GENERAL COUNSEL

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

October 23, 1981

Dennis Dutterer, Esq.
General Counsel
Room 729
2033 K Street, N.W.
Commodity Futures Trading Commission
Washington, D.C. 20581

Dear Dennis:

At a closed executive session yesterday, the Commission met to discuss progress in negotiations between our respective Chairmen and expressed support for the terms of an agreement which has emerged over the last several weeks.

I attach a copy of a brief explanatory memorandum and draft statutory language provided to our Commissioners. We look forward to hearing from you concerning the response of your Commissioners.

Sincerely,

Edward F. Greene

Attachment



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October 23, 1981

Michael Andrews, Esq.
Executive Assistant to the Chairman
Room 800A
2033 K Street, N.W.
Commodity Futures Trading Commission
Washington, D.C. 20581

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MEMORANDUM

October 23, 1981

RE: Resolution of Jurisdictional Issues Between the
Commodity Futures Trading Commission ("CFTC") and
the Securities and Exchange Commission ("SEC")

A. Background

In amending the Commodity Exchange Act in 1974, Congress expanded the definition of "commodity" to embrace not only tangible goods but to reach, for the first time, intangible rights and interests including at least some types of securities. The CFTC, created in 1974, has been given "exclusive jurisdiction" over agreements and transactions "involving" futures trading in all commodities. At the same time, Congress inserted a proviso in the Commodity Exchange Act to preserve the SEC's preexisting jurisdiction over securities trading and markets, but the language of that proviso is qualified.^{1/} In recent months, jurisdictional issues have come into play in three areas.

First, beginning in 1978 and carrying through to 1981, several boards of trade have applied to the CFTC for permission to trade futures on stock indexes or futures on a small number of stocks in particular industrial groups. Indeed, in 1981 one board of trade (the New York Futures Exchange) applied to the CFTC for authority to trade futures on the bonds of a single issuer, AT&T. In various written comments to the CFTC and in testimony, the SEC has expressed concern that CFTC approval of futures trading on securities indexes or individual securities could lead to creation of a separate securities market beyond the effective supervision of the SEC.

A second area of uncertainty involves the CFTC's exclusive jurisdiction over commodity pools -- entities analogous to investment companies, but which invest in commodity futures contracts instead of (or in addition to) traditional equity or debt securities. Historically, the CFTC has refrained from asserting that its exclusive jurisdiction over commodity pools preempts applicability of the registration and reporting requirements of the Securities Act of 1933 and Securities Exchange Act of

^{1/} Immediately following the grant of exclusive jurisdiction to the CFTC over futures trading, Section 2(a)(1) of the Commodity Exchange Act provides that "[E]xcept as hereinabove provided, nothing contained in this section shall (i) supersede or limit the jurisdiction at any time conferred on the Securities and Exchange Commission * * *."

1934, ^{2/} and it has been the SEC's consistent position that provisions of the 1933 and 1934 Acts apply to commodity pools which engage in a public offering of their own securities and thereafter enjoy the status of public companies. At the same time, the SEC has not sought to apply the substantive regulatory scheme of the Investment Company Act to commodity pools based merely on their trading in futures on U.S. government issued or guaranteed securities.

Third, the SEC, in February 1981, approved a rule proposal of the Chicago Board Options Exchange to create a market for options on GNMA securities, based upon its determination that Congress' grant of jurisdiction to the SEC over the trading of securities on securities exchanges is undiminished by the Commodity Exchange Act, and that the exclusive jurisdiction of the CFTC over futures trading of GNMA securities did not extend to other distinct forms of trading, including options trading directly on GNMA securities. The Chicago Board of Trade has filed a petition for review of the SEC's action, Chicago Board of Trade v. SEC, (No. 81-1660), contending that the CFTC's exclusive jurisdiction extends to GNMA securities options, and the CFTC has supported this contention in amicus briefs filed with the Court of Appeals. All briefing has been completed in the litigation, and oral argument is scheduled in the Seventh Circuit on November 4.

To explore a possible resolution of jurisdictional differences, CFTC Chairman Johnson and SEC Chairman Shad have conferred on a regular basis over the last several weeks and the terms of such resolution have emerged.

B. Preliminary Resolution

As reflected in the Summary of Terms (Appendix A) and draft statutory amendments (Appendix B), Chairman Johnson and Chairman Shad have reached a tentative resolution on the following points:

1. CFTC Jurisdiction over Futures (and Options on Futures) on Individual Securities

The CFTC would have no authority to approve or regulate the trading of options, futures, or options on futures on any individual corporate equity or debt or municipal security.

^{2/} In February, 1981, however, the CFTC wrote to the National Association of State Securities Administrators asserting that its jurisdiction preempted any state disclosure requirements imposed on commodity pools. The CFTC's February letter implicitly raises a question about the applicability of the Securities Act of 1933 to commodity pools.

This would be accomplished by amendments to Section 2(a)(1) of the Commodity Exchange Act (Appendix B at p. 1) and addition of a new Section 2(a)(2) (Appendix B at p. 2).

The CFTC would retain, however, authority to approve futures trading and options on futures involving certain securities which are "exempt" securities under the 1933 and 1934 Acts, namely: (1) securities issued or guaranteed by the U.S. government, (2) certificates of deposit of national banks, state member banks, and FDIC insured state banks, and (3) commercial paper (Appendix B at p. 2. See Sections 2(a)(2)(i), (ii) and (iii)). Futures trading is currently taking place on these exempt securities and, under rules recently adopted by the CFTC, the boards of trade will likely begin trading options on futures involving Treasury instruments and GNMA's. Under the proposed resolution, however, the CFTC would have no authority to permit options directly on Treasury instruments, GNMA's, or other securities.

2. CFTC Jurisdiction over Indexes of Corporate Securities

The CFTC would be expressly authorized to permit trading in futures contracts on "qualified" securities indexes, including indexes on corporate securities or municipal securities (Section 2(a)(2)(iv)). The SEC's regulatory concerns would be addressed by requiring that a "qualified" securities index be settled only by the delivery of cash (Section 2(a)(2)(a)(iv)) and be sufficiently broad-based so that futures trading in the index could not be used to further manipulation in the underlying market for any of its component securities (Section 2(a)(2)(b)). In addition, a statutory amendment would require concurrence by the SEC over the designation of an index as "qualified." Under alternative draft language, the SEC's exercise of concurrence authority would be removed from judicial review or made subject to judicial review after an informal notice and comment proceeding. The SEC would not be required to hold its own "on the record" hearing. (Appendix B, at p. 3; Section 2(a)(2)(c)).

3. SEC Jurisdiction over Options on Securities

The SEC's authority over securities options trading (including options on exempt securities) would be clarified. Clarification would be achieved by (1) expressly removing any CFTC jurisdiction over options on securities (Appendix B at p. 2), (2) amending the definition of "security" under the securities laws expressly to include both puts and calls on securities (Appendix B at pp. 4, 5, 7 and 9), and (3) amending section 9(f) of the Securities Exchange Act to make the SEC's antimanipulation rulemaking authority over

options applicable to options on exempt securities (Appendix B at p. 6). The SEC would also be able to authorize trading in options on any securities index.

D. SEC Jurisdiction over Options on Foreign Currency
Traded on Securities Exchanges

Several securities exchanges are seeking or plan to seek authority from the SEC to trade options on foreign currency. The SEC would gain express jurisdiction in this area by defining a foreign currency option traded on an exchange as a "security" (Appendix B at pp. 4, 5, 7 and 8).

E. SEC Jurisdiction over Commodity Pools

The applicability of the Securities Act of 1933 to the capital formation stage of commodity pools, and the applicability of the reporting and other provisions of the Securities Exchange Act of 1934 to publicly-held commodity pools would be clarified by amending the Commodity Exchange Act (Appendix B at p. 3). A commodity pool would not be subject to the requirements of the Investment Company Act unless the pool -- apart from its futures trading -- would separately pass the "asset" test for an investment company by investing at least 40% of its assets in traditional securities (Appendix B at p. 8).

F. SEC Jurisdiction over Futures

The SEC, by amendment to the Securities Exchange Act, would be expressly prohibited from approving or regulating futures trading on securities (Appendix B at 6).

Attachments

Summary of Principal Terms of Accord

Futures

CFTC may authorize trading in futures on securities or groups or indices of securities involving

1. government securities;
2. certificates of deposit issued by national banks, members of the Federal Reserve System, and banks insured by FDIC;
3. commercial paper notes with denominations of at least \$100,000; and
4. any qualified securities index (requires concurrence of SEC).

SEC may not authorize or regulate futures trading on a national securities exchange.

Options on Futures

CFTC may authorize options on any future it can authorize.

SEC may not authorize or regulate trading in options on futures.

Options

CFTC may not authorize trading in options on any security or securities index. SEC may authorize trading in options securities and on foreign currencies, and on indices of the foregoing.

Commodity pools

Commodity pools engaged primarily in the business of trading in futures contracts (or options on futures) and not owning investment securities with a value exceeding 40 percent of the pools' assets are not subject to the Investment Company Act. The provisions of the CEA shall not affect the applicability to commodity pools of the requirements of the Securities Act of 1933 and Securities Exchange Act of 1934.