

MEMORANDUM

October 6, 1982

TO: The Commission

FROM: Office of the General Counsel *EP Greene*

SUBJECT: Status of Amendments to the Securities and
Commodities Laws to Implement the SEC/CFTC
Accord

The following is a discussion of the current status of the legislation to amend the securities and commodities laws. The Memorandum also discusses certain issues raised in terms of Commission reapproval of orders relating to GNMA options which were invalidated by the Seventh Circuit and consideration of pending proposals relating to various other new options products.

Securities Law Amendments

On September 23, 1982, the House passed H.R. 6156, the securities portion of the SEC/CFTC Accord. On October 1, 1982, the Senate also adopted H.R. 6156, without amendment. The bill currently is awaiting the signature of the President. It was enacted substantially as proposed pursuant to the terms of the SEC/CFTC Accord, with minor changes (1) to amend the definition of "security" in Section 16(l4) of the Securities Investor Protection Act to conform to the amended definition of "security" in the other securities statutes, and (2) to add a provision amending Section 28(a) of the Securities Exchange Act to preempt the application of state gambling and bucketshop

laws to the trading of options that provide for settlement of exercises in cash.

As passed by the Congress, H.R. 6156 amends the securities laws to clarify the jurisdiction of the Commission over options. In particular, the definition of "security" in the securities statutes, including the Securities Exchange Act, is amended to explicitly include within the definition of the term any "put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities * * * or any put, call, straddle, option or privilege entered into on a national securities exchange relating to foreign currency." In addition, Section 9(f) is amended to provide that the SEC's plenary authority to regulate options trading on securities exchanges extends to options on exempted securities. Finally, the legislation adds Section 9(g) to the Securities Exchange Act to provide that "[n]otwithstanding any other provision of law, the Commission shall have the authority to regulate the trading of any put, call, straddle, option, or privilege on any security * * *." (See Attachment A).

Commodities Law Amendments

On September 23, 1982, the House adopted H.R. 5447 to amend the commodities laws. Among the provisions of this bill are amendments to the commodities laws to implement the SEC/CFTC Accord, including a provision designed to prevent the CFTC from exercising any jurisdiction over options on securities. Specifically, Section 2(a)(1)(B) of the CEA would provide that the Act "shall not apply to and the [CFTC] shall have no juris-

diction to designate a board of trade as a contract market for any transaction whereby any party to such transaction acquires any put, call, or other option on one or more securities (as defined in Section 2(1) of the Securities Act of 1933 or Section 3(a)(10) of the Securities Exchange Act of 1934 * * *.)"

On October 1, 1982, the Senate took up the commodities amendments and passed the text of S. 2109, which it substituted for H.R. 5447. As passed by the Senate, H.R. 5447 differs in a number of respects from the House version, although the only difference relating to the SEC/CFTC Accord concerns Commission participation in the CFTC process of designating boards of trade as contract markets for futures on stock indices. According to the House version, the Commission must make an affirmative finding that a particular proposed stock index futures contract conforms to the standards prescribed by the Accord (this provision has been referred to as the "SEC veto" and was added by the House Energy and Commerce Committee). The Senate version conforms to the terms SEC/CFTC Accord as originally announced and requires that the CFTC only consult with the SEC, but permits the SEC to seek judicial review if its objections are not heeded. If the Senate version of H.R. 5447 is not accepted by the House, the legislation will have to be submitted to a conference committee for reconciliation when Congress reconvenes following the elections (which we understand may be as late as November 29, 1982).

New Options Product Proposals

As the Commission is aware, the United States Court of Appeals for the Seventh Circuit in Board of Trade of the City of Chicago v. Securities and Exchange Commission, 677 F.2d 1137 (1982), and in a companion unpublished decision, overturned Commission orders approving (1) a proposal of the Chicago Board Options Exchange to trade options on GNMA securities and (2) a proposal by the Options Clearing Corporation to issue GNMA options and to clear and settle GNMA options transactions. Specifically, the court of appeals held that a GNMA option is not a "security" as that term is defined in Section 3(a)(10) of the Securities Exchange Act, and that, on the basis of Section 9(f) of the Securities Exchange Act, the Commission has no authority to regulate puts and calls on exempted securities. Alternatively, the court of appeals held that, irrespective of their status under the securities laws, GNMA options are subject to the exclusive jurisdiction of the Commodity Futures Trading Commission, and, accordingly, trading in such instruments is unlawful pursuant to Section 4c(c) of the Commodity Exchange Act ("CEA") -- the so-called "commodity options ban."

The completion of Congressional action on the securities law amendments, but not on the commodities law amendments, raises the question whether the Commission, in light of the Seventh Circuit decision, has the requisite authority either to proceed with consideration of pending new options product proposals or to reapprove the Commission orders invalidated by the Seventh

Circuit. In this regard, the securities law amendments remove any doubt as to the status of options on securities as securities. The amendments also establish that options on foreign currency are securities and that the Commission has authority to regulate such instruments when traded on a national securities exchange. Accordingly, the amendments appear to remove any doubt raised by the first part of the Seventh Circuit holding.

Whether the Commission's jurisdiction over options on exempted securities is nevertheless preempted by the CFTC could, however, be challenged due to the failure of Congress to enact the contemplated amendments to the commodities laws. Nevertheless, the "[n]otwithstanding any other provision of law" language in Section 9(g) of the Securities Exchange Act could be read to preclude application of the CEA to the instruments enumerated in the provision, and thereby effectively to overrule the Seventh Circuit decision. There are statements in the legislative history to support this proposition. 1/ The legislative changes to the commodities and securities law developed pursuant to the Accord, however, were designed as a package and there are statements in the legislative history that amendments to both

1/ See Report of the House Committee on Energy and Commerce to Accompany H.R. 6156, H.R. Rep. No. 97-626, Part I, 97th Cong., 2d Sess. 8 (1982) (Attachment B) and Statement of Senator D'Amato, Cong. Rec. S. 13112 (October 1, 1982) (Attachment C).

the securities and commodities laws are necessary to legislatively overrule the Seventh Circuit decision. 2/

Because of the nature of the statutory language, and in light of the absence of clear contrary legislative intent, we believe that the Commission may proceed with new options product approvals and reapprovals at this time, rather than awaiting final enactment of the commodities law amendments contemplated by the SEC/CFTC Accord. We intent to provide the Commission with a legal opinion concerning these issues in the near future.

2/ See Report of the Senate Committee on Banking, Housing and Urban Affairs to Accompany S. 2260, S. Rep. No. 97-390, 97th Cong., 2d Sess. 5 (1982) (Attachment D) and Statement of Senator Huddleston, Cong. Rec. S. 13114 (October 1, 1982) (Attachment C).