

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

November 13, 1975

Honorable William T. Bagley  
Chairman  
Commodity Futures Trading Commission  
1120 Connecticut Avenue, N.W.  
Washington, D.C. 20036

Dear Chairman Bagley:

On October 20, 1975, the Board of Trade of the City of Chicago commenced the trading of contracts for future delivery of mortgage backed certificates guaranteed by the Government National Mortgage Association ("GNMA"), following its designation, on September 11, 1975, by the Commodity Futures Trading Commission ("CFTC"), as a contract market for such trading. You have advised us, in addition, that the International Monetary Market of the Chicago Mercantile Exchange, Inc., presently has pending before the CFTC an application for designation as a contract market for the trading of contracts for future delivery of Treasury Bills.

We have previously advised you of our view that GNMA certificates and Treasury Bills are securities, as that term is defined in the federal securities laws. We also believe it to be quite clear that contracts for future delivery of those securities are also "securities." You, in turn, argue that the Commodity Exchange Act, as amended, grants exclusive jurisdiction over trading in contracts for future delivery, including contracts for future delivery of securities, to the CFTC.

We therefore have a situation where two distinct statutory and regulatory schemes appear applicable, in a manner not yet precisely determined, to a variety of transactions and relationships involving securities. The resulting questions may be viewed as legal, in the sense that they arise from the application and interpretation of statutes. But the most important aspect is the effect, in terms of policy and the public interest, of the interaction of these two statutory schemes as they affect investors and other participants in the market place, the professionals operating in those markets and the markets themselves. We believe that rather than merely asserting legal conclusions, both the CFTC and this Commission must address themselves to these considerations. Responsible administrative action by both agencies is required if we are to fulfill the justifiable expectations of public investors, as well as the legitimate desires of those effecting transactions in futures contracts for some degree of certainty and predictability in terms of the regulatory requirements to which they must adhere, and the liabilities which they may incur.

Both the CFTC and this Commission should be concerned, not with bare questions of jurisdiction, but with a number of important questions relating to the integrity and viability of our capital markets, and the effect futures trading will have on the securities markets and on public investors therein. To assist you in understanding our concerns, there are set forth below a number of questions which we feel remain unresolved:

(1) Can a meaningful distinction be drawn, for purposes of the exclusive jurisdiction provision of the Commodity Exchange Act as amended, between securities options contracts and futures contracts on securities, and, if so, what is it?

(2) Can a meaningful distinction be drawn between futures contracts on Treasury bills and GMNA's, on the one hand, and futures contracts on other securities such as commercial paper or industrial common stocks, on the other?

(3) Who will participate in futures markets for securities, and what effects will noncompliance with some or all of the securities laws engender?

(4) In light of the provision in the Commodity Exchange Act as amended, preserving all jurisdiction conferred on the courts, can the courts continue to entertain private actions under the federal securities laws, even if the Commodity Exchange Act is construed as ousting the regulatory authority of this Commission, and what problems would arise from such anomalous situation? Or are we to be left solely with the remedy of parcing amicus curiae in private actions?

(5) What is the potential impact of the liabilities which would exist by virtue of rescission rights available under Section 12(1) of the Securities Act of 1933, in the event it should ultimately be determined that futures contracts were sold in violation of the registration provisions of that Act?

(6) More broadly, if the exclusive jurisdiction of the CFTC is not regarded as constituting a repeal, pro tanto, of the securities laws, including securities legislation enacted after the enactment of the Commodity Exchange Act as amended, but merely as eliminating, to some extent, the jurisdiction of this Commission under those laws, in what manner will those laws be implemented, administered and enforced, and by whom? In this regard, since such exclusive jurisdiction as is granted to the CFTC is couched in terms of "accounts, agreements . . . and transactions," is it the CFTC's position that this Commission retains jurisdiction over other matters, such as persons and entities?

(7) What types of information are needed by persons trading in futures contracts on securities and what disclosures should be required to be made to them?

(8) Who has jurisdiction over licensing or registering of brokers and dealers selling futures contracts on securities--the CFTC, this Commission or both agencies? If a broker-dealer which is registered with us engages in misconduct in transactions in futures contracts on securities, can the firm be subject under any circumstances to disciplinary action by this Commission for such misconduct?

(9) Which agency has regulatory authority with respect to the representations made by a firm to its customers in transactions in futures contracts on securities, particularly in situations where the firm also advises its customers as to the relative merits of investing in the underlying securities themselves, or in other securities?

(10) What is the potential for manipulative and other abusive practices in securities trading as a result of transactions in futures markets for securities? What regulatory safeguards should be established to deal with such practices, and which agency has jurisdiction over those matters?

(11) What regulatory provisions are needed to protect investors from over-extending themselves financially in the purchase of futures contracts on securities, and which agency has jurisdiction over those matters?

(12) What problems are likely to arise in connection with the delivery of the underlying securities? What regulatory safeguards should be established in this area, and which agency has jurisdiction to deal with problems and correct abuses arising in connection therewith?

(13) What are the relationships between a futures market in a security and the market in the underlying security itself?

(a) What effects will the existence of the futures market have on the market for the underlying security? What jurisdiction and responsibility does the CFTC view itself as having for dealing with these effects? Will the CFTC's view as to its jurisdiction and responsibility impair the ability of this Commission to regulate the underlying market? Could the CFTC designate an existing securities exchange, registered with this Commission, to trade futures contracts on securities, and, if so, what would be the effects?

(b) To what extent will the existence of the futures market result in the diversion of investors' funds from capital-raising functions, and what will the consequences be for investors, the securities markets, and the economy? How will each of us monitor these matters, and what effect should resulting information have on our respective regulatory obligations?

(14) What is the relationship between a futures market in a security and a market for options on the security? Is it undesirable for both such markets in the same underlying security to exist simultaneously? Does this Commission fully retain its authority to regulate the options market? What authority, if any, is vested in the CFTC to regulate the options market?

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The effective fulfillment of our respective mandates requires, at a minimum, that we take steps, jointly and severally, to insure that broadly asserted positions are the result of a careful analysis of the important pragmatic and policy questions, set forth above, and not just facile interpretations of ambiguous statutory language.

Whether or not you agree that we can assert jurisdiction over trading in futures, contracts on GMNA certificates, Treasury Bills or any other security, we think you will agree that prudence requires that an effort be made to monitor the results of trading thus far commenced on futures contracts on GMNA certificates. Naturally, if you should authorize futures trading in Treasury Bills, a similar monitoring effort would have to be commenced with respect to those instruments as well.

We are sure you recognize the importance of cooperation in attempting to resolve the questions we perceive to be raised by the progress of this matter to date, and that you will supply us with such information as you may obtain from any monitoring program you institute on your own. Needless to say, such other options as may be available to us, including the assertion of claims under the federal securities laws and other similar actions, remain as alternatives should circumstances so dictate.

But, we assume that a monitoring program will give us a clearer indication of the existence or non-existence of some of the problems we have suggested, and it surely is a more responsible way to proceed. Accordingly, we strenuously urge that, whatever your decision with respect to Treasury Bills, no further action be taken to permit trading in futures contracts on other securities. Until we have clarified the questions raised above, either through a monitoring program, or through hearings pursuant to our own statutory authority, or until the Congress has been given an opportunity to consider whether it wishes to draw different distinctions than the ones that presently exist in the organic acts of our two agencies, such trading would be premature.

For the Commission.

Sincerely,

Roderick M. Hills  
Chairman