Shad

U.S. House of Representatives
Committee on Energy and Commerce
Room 2125, Rayburn House Office Building
Washington, DC 20515

September 15, 1986

Honorable John S. R. Shad
Chairman
Securities and Exchange Commission
450 Fifth Street, N. W.
Washington, D. C. 20549

Dear Chairman Shad:

This is with reference to the Commission's letter of August 20, 1986, the transcript of the Commission's August 8, 1986 open meeting, the Division of Market Regulation's letter of August 8, 1986, and the action and discussion memoranda of July 30, 1986, regarding (1) Commission consideration of the appropriate regulation of over-the-counter automated trading systems and (2) the no-action request submitted by Security Pacific National Bank on behalf of its proposed system for trading options on U.S. Treasury securities.

The Commission's discussion and vote on the staff's reaffirmation of its no-action position with respect to exempting Security Pacific from exchange registration under Sections 3(a)(1), 5 and 6 of the Securities Exchange Act of 1934 (1934 Act), and granting the no-action request with respect to the definition of security under Section 3(a)(10) of the 1934 Act, raise a number of serious policy and legal issues.

In order to assist us in evaluating those issues, it is requested that you provide us with responses to the following questions by the close of business on Friday, October 10, 1986.

1. The term "exchange" is defined in Section 3(a)(1) of the 1934 Act to mean any organization which "provides a market place or facilities [defined as including communications systems] for bringing together purchasers and sellers of securities." Under the Security Pacific proposal, doesn't it provide facilities for bringing together purchasers and sellers of securities?

2. Assuming that the Security Pacific trading system constitutes an "exchange" as defined in the 1934 Act, is

there any provision in the Act (other than the exemption procedure set forth in Section 5, which was not followed in this case) that authorizes the SEC or its staff to exempt the trading system from exchange registration? Explain fully.

3. Under the Security Pacific proposal, it appears that the options will be issued by GECC Options Corporation (GOC), a subsidiary of General Electric Credit Corporation, and the options transactions will be cleared by the Security Pacific Options Services Corporation (SPOSC). With respect to equity options, these functions are performed by the Options Clearing Corporation, which is registered with the SEC as a clearing agency pursuant to Section 17A of the 1934 Act. Will GOC and SPOSC be required to register as clearing agencies with the SEC? If not, what government agency will be responsible for regulating their activities?

4. Will the prospectus for the options to be issued by GOC contain all of the disclosures required by SEC Rule 9b-1 for standardized options? Will the terms and conditions of the financial guarantees be fully disclosed? Will the risks of holding an options position that cannot be offset in a liquid market be fully disclosed? Will the risks that contracts entered into in the proposed Security Pacific market may be void and unenforceable under Section 29(b) of the 1934 Act and that broker-dealers who effect transactions in the market will be in violation of Section 5 be fully disclosed?

5. How can the SEC approve such a radical new venture in trading government securities at a time when both houses of Congress have drafted and are nearing final passage of comprehensive regulatory legislation for trading government securities (H.R. 2032 and Report No. 99-258; S. 1416 and Report No. 99-426) as a result of persistent, massive frauds?

6. At your August 9, 1986 meeting to approve the Security Pacific no-action proposal, the Commission discussed the different regulatory implications for the proposal under the two pending versions of legislation to regulate the government securities markets. As the Commission recognized, under the House bill both GOC and SPOSC will be required to register as clearing agencies. Under the Senate bill, however, registration may not be required. In light of this fact, has the Commission taken any steps to ensure that Security Pacific will postpone implementation of its proposal until the enactment of the government securities legislation, which will clarify these registration issues? If not, doesn't the Commission believe this

would be a prudent and appropriate step? In the interim, what kind of disclosure will Security Pacific and GOC be required to make to investors concerning the potential impact of the government securities legislation, including the possible illegal nature of any options entered into through the Security Pacific system as a result of the failure of GOC and SPOSC to register as clearing agencies? Shouldn't prospective investors as well as participants in the Security Pacific system receive a clear warning about the potential legal consequences for these options transactions?

Thank you for your cooperation and timely response to this request.

Sincerely,

JOHN D. DINGELL
CHAIRMAN

cc: Honorable Timothy E. Wirth
Honorable Norman F. Lent
Honorable Fernand J. St Germain