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Stuart

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

September 15, 1986

WM MICHAEL KISZMILLER, STAFF DIRECTOR
 THOMAS M. ATAM, CHIEF COUNSEL

Honorable Paul A. Volcker
 Chairman
 Board of Governors of the
 Federal Reserve System
 20th and Constitution Avenue, N.W.
 Washington, D.C. 20551

Dear Chairman Volcker:

This letter is with reference to the Security Pacific National Bank's proposed system for trading options on U.S. Treasury securities.

That proposal raises a number of serious policy and legal concerns and your assistance is requested in helping us to resolve those issues. Please provide answers to the following questions by the close of business on Friday, October 10, 1986.

1. Doesn't the Security Pacific proposal involve non-banking activities in violation of the Glass-Steagall Act and the Bank Holding Company Act? Explain fully.
2. Security Pacific has agreed to issue a letter of credit payable to GECC Options Corporation (GOC) in an amount not to exceed \$35 million dollars in the event that one or more participants in its trading system default. What are the provisions of this letter of credit? By issuing the letter of credit, isn't Security Pacific still guaranteeing all option trades in its system up to \$35 million dollars? Is there anything to preclude Security Pacific from later increasing the amount of the letter of credit? Does this new mechanism, and the related GOC guarantee arrangement, constitute an evasion of federal banking law, including the Bank Holding Company Act?
3. Have the Federal Reserve Board, Comptroller of the Currency and the FDIC approved this venture of Security Pacific? Has Security Pacific filed with any of the

bank regulators any applications or requests for no-action letters? If so, please explain any actions taken by the regulator or its staff in response to these Security Pacific filings.

4. Security Pacific has stated that the brokerage and clearing functions for its options system will be performed by Security Pacific Options Services Corporation (SPOSC) and Security Pacific Options Trading Corporation (SPOT). SPOSC and SPOT are subsidiaries of the bank's holding company parent, Security Pacific Corporation (SPC). As bank holding company subsidiaries, aren't SPOSC and SPOT subject to FRB jurisdiction under the Bank Holding Company Act? Don't SPOSC and SPOT need prior FRB approval, or approval by a regional FRB bank, under Section 4(c)(8) of the Act before engaging in these activities? Has such approval already been granted and if so, when and why? If you have not granted such approval, is an application pending? If so, please provide a copy of the application. If you have not received an application, please provide a copy of any application when filed. Is there any lawful procedure for SPOSC and SPOT to begin to engage in these activities without first receiving approval of this application? Has the FRB or its staff conferred with Security Pacific concerning its plans to comply with these requirements? If so, please explain the substance of these discussions.
5. Under the Bank Holding Company Act, has the FRB ever approved an application of a bank holding company subsidiary to engage in the type of novel activities contemplated for SPOSC and SPOT? Has the FRB ever disapproved a similar application? If so, what grounds were cited by FRB? Has the FRB ever disapproved a related application regarding options and futures brokerage or clearing activities? Again, if so, what grounds were cited by FRB?
6. Existing FRB precedent strongly supports disapproval of any application Security Pacific Corporation might make under Section 4(c)(8) of the Bank Holding Company Act to engage in the proposed brokerage and clearing activities of SPOT and SPOSC, respectively. In granting other applications to perform brokerage and clearing functions for options, the FRB has recognized the potential adverse effects of these actions but approved the applications because the options trading would occur on SEC-regulated exchanges.

For example, in approving an application of a subsidiary of the bank holding company at issue here, Security Pacific Corporation, the FRB stated:

The Board has considered several issues with respect to possible adverse effects.... [I]n evaluating Applicant's proposal to act as a broker of options on U.S. Government ... securities ..., the Board has taken into account and has relied upon the regulatory framework established pursuant to law by the SEC for such trading....

Security Pacific Corporation, 70 Federal Bulletin 53, 56 (1984). Similarly, in approving another application to broker and clear options traded on a registered securities exchange the Board observed:

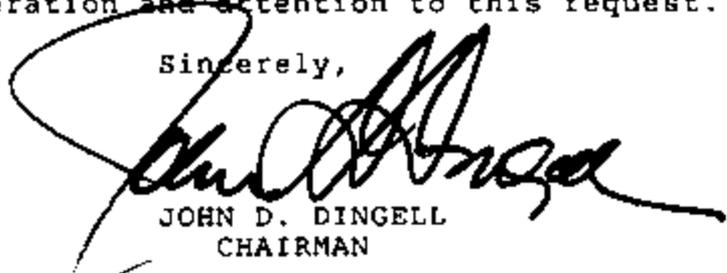
The Board has also considered the potential for adverse effects that may be associated with this proposal. In particular, the Board has taken into account and has relied on the regulatory framework established pursuant to law by the SEC for the trading of options.

Fidelcor, Inc., 70 Federal Reserve Bulletin 368, 369 (1984). Since the Security Pacific options proposal deliberately deviates from the securities laws' regulatory framework for options, it would appear to follow that perceived potential adverse effects of the planned brokerage and clearing activities of SPOT and SPOSC would not be counter balanced by any appropriate regulation and could not be approved under existing precedent. Is my understanding of the FRB precedent and position accurate?

7. Do you believe that the establishment, promotion and operation of an options exchange is "closely related to banking" within the meaning of Section 4(c)(8) of the Bank Holding Company Act?

Thank you for your cooperation and attention to this request.

Sincerely,



JOHN D. DINGELL
CHAIRMAN

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