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Statement of the Shadow Financial Regulatory Committee on the Brady Commission

November 13, 1987

The October 19 stock market crash resulted in the appointment of a Presidential commission (the Brady Commission) to determine its causes and suggest additional regulatory safeguards if necessary. The Commission must present its findings to the President within sixty days. The Shadow Financial Regulatory Committee is concerned that the time and political pressures faced by the Brady Commission will result in its recommendation inappropriate and ill-advised but convenient "regulatory actions".

The Committee believes that the experience on October 19 and on its aftermath show two important facts about our financial system. First, both the securities and futures markets continued to operate in the midst of the sharpest market decline in the history of the United States. Except for brief periods, both markets were open and trading was continuously conducted. Indeed, our present system of exchange and securities protection appears to have worked reasonably well.

Second, there may be some incompatibility between the trading policies in securities and futures markets. Trading in stock index futures necessarily requires simultaneous trading in both markets. The events of October 19 revealed that actions taken by one market to "protect" itself, e.g., suspension of trading, can have serious repercussions for the other market. Thus, better co-ordination appears needed between these two markets.

The events of October 19 provide an opportunity for experts to study the advantages and disadvantages of both trading systems, determine the critical links between the systems, and decide whether additional institutional mechanisms can be developed to assure their smooth functioning, even during the kind of extreme turbulence experienced on October 19. However, sixty days is simply not enough time to make such meaningful analysis.

As a result, the Committee is concerned that the Brady Commission, as well as the other study groups being established, may seek to pacify critics and other concerned parties by pointing to a few scapegoats and by proposing additional unnecessary and ill-advised regulation without a thorough analysis of the potential effects of those regulations.

For example, futures markets and certain futures trading strategies, such as program trading and portfolio insurance, have already been identified as possible culprits, and restrictions on futures trading have been proposed. Thus, higher governmentally-imposed margin requirements, daily price limits, and position limits are being discussed as potential remedies, despite a substantial body of research that suggests that such regulations are an inappropriate response to the recent market events.

Furthermore, as presently constituted, the Brady Commission does not include sufficiently knowledgeable market-makers, regulators, market users, and academics. An enhanced committee to examine the operation of both the stock and futures market systems and the linkage between them, and its timetable should be extended at least until the end of March 1988.

The Committee also is concerned that the events of October 19 will be used in an inappropriate way by some private interest groups to further their goals. A case in point is the contention that these events demonstrate that we should not discard or liberalize the Glass-Steagall Act to permit greater commercial bank securities powers. Although such arguments should be subjected to a careful analysis, the Committee has found little relationship between what happened on October 19 and the issues which underlie the Glass-Steagall debate and does not believe that this even should delay meaningful reform.

It is the Committee's policy that members abstain from participating in the formulation of policy statements in instances in which they have a direct personal or professional involvement in the matter that is the subject of the statement. Accordingly, Mr. Hawke abstained from participating in or voting on this statement.