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Summary of Testimony

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It seems to me that the case supporting a single Federal regulator for both the cash markets for securities and derivative instruments does not require a long or a complicated statement. There is no alternative if we wish to provide orderly securities markets in which the investing public can have faith.

In late 1987 over 40 members of a Presidential Task Force spent an intensive 60 days investigating the terrifying market gyrations of October 16th through 20th. This was a diversified group of talented, experienced and dedicated people from all aspects of the investment business and from academia. Their first and most important conclusion reached was that the cash market and the futures market are <u>one</u> market. Buying or selling pressure in either market is instantly transmitted to the other. If regulation is required to provide fair, equal access to users of the exchanges and to protect them from unfair practices on the part of "insiders", then this regulation must be coordinated between cash and futures, and must come from one regulator.

In the last 30 months, our securities markets have had two near "meltdowns". No one knows how close we came to disaster or how calamitous the consequences would have been. These near misses are linked to the rapid growth of computer-driven trading strategies by investors and the development of high volume, computer-based order transfer systems by the exchanges in response to this new demand. Many of these new strategies involve arbitrage orders that are "price sensitive". Never before have our markets had to cope with waves of big volume buy or sell orders that must be executed at the best price available ... no matter what that price is.

The Task Force concluded that a protection our markets need to cope with these new forces is a system of circuit breakers or "time outs". Such circuit breakers are needed to allow information dissemination during chaotic trading conditions when most investors do not have access to enough real time data to participate. It is absolutely clear that circuit breakers must be applied harmoniously to both the cash and the futures markets and must come from a single regulator.

Our securities markets may be in several geographical locations but they are <u>one</u> market. Rules must be put forth on margin requirements, capital requirements for dealers, qualifications for dealers and floor brokers, clearing mechanisms and a variety of other factors. All these rules should come from a single regulator.

For the better part of a century, until 1975(?) the Chicago markets dealt with commodities and the New York markets with securities. The former was regulated by the CFTC under legislation created by congressional committees focused on and expert in agriculture. The SEC regulated the New York markets through congressional legislation from banking and finance experts. It is dangerous in the extreme to allow this separation to continue now that large and active futures markets have developed.

The SEC and the CFTC not only fail to cooperate and work together for the public good; they actually engage in counter productive activities based on an old fashioned "turf war". The SEC may not be everyone's first choice as the single regulator, but obviously it is a much more logical choice than the CFTC.

The Task Force recommended The Federal Reserve as the single regulator of securities and derivatives markets. This would be a good choice. However, the FED does not want the responsibility, and time is of the essence. I am most concerned that our luck (and that is probably what saved us) could run out in the next computer-based onslaught on our securities markets, and we will find out what "meltdown" really means.

Part of the original reason for changes in the rules on margin requirements for security purchases and sales following the crash of 1929 involved the concept of social responsibility. The very low margin requirement of the late 1920s permitted professional and public speculation to rise to unprecidented levels. Margin requirements should be used to serve the social purposes today. However, if margin rates are set for the cash markets by one body and for the futures market by another, the result can be chaotic at best and very destructive at worst.

Over the past three years, activity in the futures market has frequently involved dollar volumes two times and more over activity in the cash markets. There is no doubt in my mind that this relationship is a good measure of the level of speculation. When the value of futures actively exceeded the value of cash market activity by historically high levels during the first nine months of 1987, the CFTC took no action whatever to discourage a growing level of public and professional speculation.

We know that there is a difference between "margin" in the cash markets and in the futures markets. In the former, margin is a down payment on a purchase. In the latter, margin is a fidelity bond to insure future performance on the agreed futures contract. However, the fact is that most of the time in recent years, a user of an S&P futures contact has been able to control close to $150,000 in common stock with collateral or a cash deposit of less than $10,000. This is an open invitation to speculate during periods of public euphoria. With two regulators, each having a proprietary feeling about its own markets, neither is likely to do anything to reduce the attraction of one market in relation to the other. The only possible way to use changes in margin to moderate booms and busts due to excessive speculation is to have a single regulatory authority.

Every arguement I have read (and there have been many) for maintaining CFTC regulation of the futures and options markets has been largely self-serving and competely ignores the welfare of the investing public.

My organization manages some $20 billion primarily in global equity portfolios. We have no interest, plus or minus, in the prosperity of the NYSE of the Chicago futures markets. We are only interested in fair, orderly securities markets with reasonable liquidity in New York, London, Tokyo and elsewhere. Our business is bound to be effected adversely by any ongoing decline in the public's confidence in the world's major capital markets.

Our clients are long term investors who believe greater gains will be made through committing capital to sound business enterprises on an ongoing basis, than by attempting to capitalize on short term fluctuations in the market and individual stocks. Despite a continuing study of the use of futures and option in the managing of clients's portfolios, we have never found evidence that derivatives are likely to produce better rates of return. We have never used futures or options and are unlikely to do so in the future.