United States Senate

COMMITTEE ON BANKING, HOUSING, AND
URBAN AFFAIRS
WASHINGTON, DC 20510-6075

November 23, 1987

Mr. Brian L. Kastman
1523 Edgeridge Circle
Kalamazoo, MI 49008

Dear Mr. Kastman:

Thank you for your letter of October 30, 1987 describing your personal experience and insights into the October 19 stock market break. I know that you had several conversations with Jim Arbury about the events in mid-October. I am sorry that the market collapse affected you and your clients so drastically.

Your experiences during the week of October 19 tend to confirm a growing number of reports and rumors regarding the operation of broker/dealer order execution systems and the performance of market makers and specialists under the stress of the market collapse. Securities and Exchange Commission Chairman Ruder testified before the Banking Committee on November 4, 1987 on the recent market turmoil and I stressed that I expected a complete SEC review of the treatment of investors. Unfortunately, early evidence indicates that your experience was not unique. I know that a number of my colleagues on the Committee share my concern over this aspect of the market break. While it necessarily includes only speculative conclusions at this early date, I have enclosed a copy of Chairman Ruder's November 4 testimony for your information.

Your letter also includes discussion on the role of derivative products and program trading in the collapse. As I am sure you are now aware, these issues have attracted considerable attention and will be the subject of intense scrutiny over the next few months. At the present time, several separate groups are preparing factual data and recommendations based on the October 19 events:

--President Reagan has appointed Dillon Read Chairman Nicholas Brady to head a commission that will study the stock market collapse and provide recommendations early in 1988. Other members of this group include John Opel, Chairman of the Executive Committee at IBM, to provide computer technology expertise; James L. Cotton, Chairman of Navistar International Corp., representing the interests of large corporations; Robert G. Kirby, Chairman of Capital Guardian Trust Co., a money manager who will represent pension funds and other institutional investors; and Howard Stein, Chairman of Dreyfus Corp., who will represent mutual funds and the small investors who are involved in the stock market through these funds. The Brady Commission's staff director will be Harvard Business School Professor Robert Glauber, who will be assisted by Harvard Business School Professor David W. Mullins, Jr.

--As you will note from the enclosed testimony, Chairman Ruder has ordered an extensive SEC staff study of a wide range of issues related to the market break.

--The New York Stock Exchange has authorized a study of stock market volatility and the stock market collapse by former IBM General Counsel Nicholas deB. Katzenbach, who plans to complete the study next month.

--The Commodity Futures Trading Commission, which regulates index futures trading, has ordered a study of the stock market collapse and market volatility. The study will have special emphasis on the relationship between trading in stocks and stock index futures and is to be completed as soon as possible.

--The Chicago Mercantile Exchange has named a panel of four experts to assist the CME in evaluating the events surrounding the market break: Yale economics Professor Burton Malkiel; University of Chicago economics Professor Merton Miller; Stanford University Professor Myron Scholes; and Washington banking law attorney John Hawke.

I believe that a good deal of expertise is now concentrated on this problem and should be able to provide Congress with the facts and some recommendations by the time the next legislative session convenes in January. I expect that we will be concentrating on the results of these studies during the first part of next year and I will keep in mind your generous offer to testify at any relevant hearings. Your experience could well prove to be instructive for the Committee; regardless, it has already been valuable for my understanding of how investors were treated during the market break.

Thanks again for your information on this issue and please feel free to communicate any additional insights you may have as we proceed.

Sincerely,

Donald W. Riegle, Jr.
Chairman, Securities Subcommittee

Enclosure