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# Business

## Different Products Need Different Rules

BY LEO MELAMED

**I**N 1982, when futures markets came up with the idea of stock index contracts, the securities industry said it was a silly idea that would not work. Later, when it did work, the industry said it was the work of the devil and ought to be banned. Later, when most academicians lauded these contracts as indispensable risk-management tools, the securities exchanges decided that maybe it was a good idea after all. You would think that this was the end of the story, right? Wrong.

The American Stock Exchange and Philadelphia Stock Exchange went about creating their own versions of stock index futures, the so-called index participation contracts. So far so good. But then they brashly stated that these were not copycat futures, but their own innovative new securities. How silly can you get?

Index participations are simply futures contracts. They have all the attributes of futures contracts — daily settlement, expiration dates, payments in cash, and so on. Conversely, they do not possess any of the usual indexes of an equity product — purchasers get no interest in the governance of a company, nor do they even own the underlying shares.

So what is the big deal? Why be so technical? For years, the Russians claimed they invented the Model T Ford, but we did not let a little technicality like that stand in the way of better relations, did we?

Ah, but the plot thickens. Rather than list index participations as futures contracts with the Commodity Futures Trading Commission, where there would have been no legal squabbles, the American and Philadelphia Exchanges chose to list the index participations with the Securities and Exchange Commission, where they knew there would be legal objections. Now that is what I call chutzpah. At least the Russians did not take their claim to court.

On Aug. 18, 1989, a Federal appeals court ruled that index participations are, in fact, futures contracts and

subject to regulation by the C.F.T.C. The two exchanges and the S.E.C. were livid.

Not only is the appeals court's opinion correct as a matter of logic and law, and on broad policy grounds, but the complaints of the exchanges and the S.E.C. are a smoke screen. It is another attempt to capture the benefits of futures industry innovations without competing fairly. If these products are valuable, why not list them on the futures divisions at the securities exchanges?

Conversely, the futures industry has no quarrel with legitimate securities products. For example: Even as the American and Philadelphia Exchanges were pursuing the stock index contracts, the New York Stock Exchange proposed the development of a genuine securities basket product whereby a purchaser would actually own the stocks in the basket. The futures exchanges had no objections.

Having lost the legal argument, the two exchanges and the S.E.C. are now resorting to specious cries that the court's ruling stifles competition and that Congress must come up with a cure. Presumably, either with legislation overriding the so-called Shad/

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Johnson pact (which in fact preserved for futures markets only a portion of what they had pioneered, gave the S.E.C. veto power over stock index contracts and severely restricted the potential of new types of futures) or by creating a single regulator. In other words, doing away with the C.F.T.C.

The idea for a single regulator has been advanced for a variety of purposes — usually to the advantage of the securities industry. Prof. Daniel R. Fischel, at the University of Chicago, analyzed the Brady Report with respect to this issue. In his study, he dismisses the one-agency concept by saying there is no evidence implying that competition among regulators is harmful, nor that cooperation requires a single agency.

Similarly, S.E.C. Commissioner Edward Fleischman has pointed out that the fundamental differences between securities and futures are sufficient reason not to give the S.E.C. jurisdiction over financial derivative products. He, too, concludes that regulatory competition is healthy.

**O**NE need only take a brief historical glance to grasp why the two-agency concept has been beneficial to the American financial community. For instance, who recognized that modern techniques of financial risk management require an array of new products? Who recognized in 1972 that the collapse of fixed exchange rates would require a market for currency futures? Who understood the need for a hedging mechanism for interest-rate risk exposure? Who conceived of stock index contracts? The futures markets did. Would that have happened under the S.E.C.? Exchange-traded options, the only successful new securities product during this period, was devised by a futures exchange.

So come on guys, give us a break. Take the loss like a good trader and invent something of your own. ■

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