US Congress must ‘learn from ugly episode’ of GameStop trading

Former BoE deputy governor Paul Tucker urges greater scrutiny of clearers and brokers

Paul Tucker urged legislators in Washington to ‘learn from an ugly episode’ © Martha Stewart

Philip Stafford 8 HOURS AGO

Former Bank of England deputy governor Paul Tucker has written to the US Congress urging it to “learn from an ugly episode” surrounding January’s frenzied trading in GameStop shares, and to examine whether standards for the broker and clearing house central to the drama were sufficiently robust.

Tucker’s intervention comes through his role of chair at the Systemic Risk Council think-tank, which also includes former regulators and financial policy officials Sheila Bair, Brooksley Born and Jeremy Stein.

Sir Paul, now a fellow at Harvard Kennedy School, said while the retail trading surge was not a direct threat to financial stability, “Congress should ensure the unfinished business of rebuilding the financial system’s resilience resumes”.

The SRC raised concerns that authorities did not use their powers to raise margin requirements and cap the leverage available to retail traders before brokers were effectively forced to suspend new GameStop purchases.

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SRC letter

The SRC drew particular attention to National Securities Clearing Corporation, the clearing house thrust into the spotlight by January's explosive trading. Broker Robinhood said an outsized request for more margin from the clearing house was a critical factor in its decision to restrict some share trading — a move that provoked angeramong customers and high-profile politicians, leading to the first in a series of congressional hearings last month.

A clearing house stands between a buyer and a seller, ensuring assets are legally transferred from one to the other. As the process is completed over two days, it demands its members deposit margin funds, to cover risks in case the trade fails.

The SRC said it was legitimate to ask if the clearing house's requirements were too low to start, and whether its internal processes and those of its regulators were fit to cope effectively with the situation they faced in an environment where retail trading is growing rapidly.

The clearing house's demands for margin from the industry rose from $26bn to $33.5bn that week. Robinhood's own requirements increased 10-fold and it needed to find $3bn within hours — a figure it negotiated down to $700m.

In its testimony to Congress last month DTCC defended the extra charges it initially levied on the industry, arguing it "reflected significant growth in risk in many clearing members' unsettled portfolios". It used a permitted discretion to waive some charges on Robinhood and ease the pressure.

The SRC also said lawmakers should ask if brokers such as Robinhood were holding enough capital in reserve to cover sudden bursts in trading. It was not a surprise that a broker trades more than its capital base can support, it said. "The question, then, is whether [regulatory] requirements are properly calibrated against the kind of volatility and the degrees of leverage that seem to characterise modern markets."