

Congress of the United States
Washington, DC 20515

May 22, 2015

The Honorable Jeb Hensarling
Chairman
House Committee on Financial Services
U.S. House of Representatives
Washington, D.C. 20515

Dear Chairman Hensarling:

We write to respectfully request that you hold a hearing to examine current lapses and potential reforms in the federal oversight of our equity markets in light of the recent allegations that Navinder Singh Sarao, a U.K. trader who had been manipulating the global financial markets from his home for years, allegedly helped cause the May 6, 2010 Flash Crash.

During the Flash Crash, the Dow Jones Industrial Average rapidly dropped nearly 600 points in 5 minutes before quickly rebounding. This event seriously damaged the reputation of U.S. equity markets.

On September 30, 2010, the Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC) produced a report that blamed the Flash Crash on one trade from Waddell & Reed, a brokerage firm based in Kansas City, Missouri.¹ This explanation now appears to be completely erroneous.

In an about-face, on April 21, 2015, the CFTC and the Department of Justice (DOJ) announced that the agencies were bringing civil and criminal charges respectively against Mr. Sarao.² As reported in the *New York Times*, “Mr. Sarao is accused of entering and withdrawing thousands of orders worth tens of millions of dollars each on hundreds of trading days, in an attempt to push down the price of futures contracts tied to the value of the Standard & Poor’s 500-stock index, a practice known as spoofing. Once the price fell, Mr. Sarao would buy the contract and reap the profits... On the day of the Flash Crash on May 6, 2010, prosecutors contend that Mr. Sarao placed large orders repeatedly over several hours, leaving the market vulnerable to big moves when another big trade came in from an investor in the United States.”³

¹ <https://www.sec.gov/news/studies/2010/marketevents-report.pdf>

² <http://www.cftc.gov/PressRoom/PressReleases/pr7156-15#PrRoWMBL>

³ <http://www.nytimes.com/2015/04/22/business/dealbook/trader-in-britain-arrested-on-charges-of-manipulation-that-led-to-2010-flash-crash.html?ref=topics>

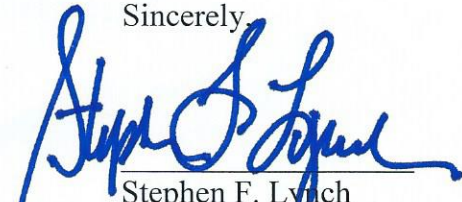
The regulators may have missed Mr. Sarao's activity because they were not looking at complete data.⁴ Former CFTC Chief Economist Andrei Kirilenko, who co-authored the report by the regulators, remarked in a recent interview that "the CFTC and SEC based their study of the sorts of futures Sarao traded primarily on completed transactions, which wouldn't spotlight the thousands of allegedly deceitful orders that Sarao submitted and immediately canceled."⁵

After reviewing both the DOJ and the CFTC cases against Mr. Sarao, we are left with more questions than answers. The fact that Mr. Sarao was able to perpetrate this alleged fraud for years before being arrested in April raises concerns about how one individual can exert so much influence over the world's financial system and the degree to which the regulators have struggled to keep pace with the rapidly evolving financial marketplace. We are concerned by the Sarao case for the facts that it presented and for the questions that it has left unanswered. The ineffectiveness of the regulators to stop the Flash Crash from occurring and to properly investigate it diminishes investor confidence. We feel we need to understand more about the Sarao case and the Flash Crash to evaluate if these allegations, and therefore the threat to our markets, are credible.


We thank you for your consideration and hope to work with you on a bipartisan basis to examine the policy implications of this. We look forward to your response.

If you have any questions regarding this request, please contact Jaclyn Cahan on Congressman Lynch's staff at Jaclyn.Cahan@mail.house.gov or (202) 225-8273.

Sincerely,




Stephen F. Lynch
Member of Congress



Keith Ellison
Member of Congress



Michael Capuano
Member of Congress



Juan Vargas
Member of Congress

⁴ <http://www.wsj.com/articles/flash-crash-investigators-likely-missed-clues-1430089384>

⁵ <http://www.bloomberg.com/news/articles/2015-04-22/flash-crash-arrest-lays-bare-regulatory-lapses-at-all-levels>