

MEMORANDUM

March 24, 1964

TO: Ralph S. Saul, Director
 Division of Trading and Markets

FROM: David Silver
 Special Counsel to the Director

SUBJECT: NYSE Floor Trading Rules

We have been analyzing the floor trading rules which the NYSE proposed to adopt. These proposals are similar to those which were rejected as inadequate at our last meeting with the Exchange representatives on March 13. In at least one respect, the rules fall short of the package offered by the Exchange on March 13-- at that time the Exchange was willing to prevent a member from acting as both a broker and a floor trader in a particular security in any 15 minute period. The only comparable provision in the proposed rules is that a member would be forbidden to floor trade when he holds an executable order for the public, e.g., on his way to execute a market order for the public, in say Chrysler, the broker may not stop off and floor trade in any stock.

In setting up a class of registered traders the new rules require registration, a test and capital. However, the capital requirement seems to be illusory in that it merely requires that the member "establish that at the time of his registration he can meet an initial minimum capital requirement of \$100,000." This apparently does not require that this capital be in addition to, or segregated from capital used in meeting other exchange capital requirements. Furthermore, the rules does not seem to impose any maintenance requirements. Most important, it seems to permit the registered trader to withdraw his capital at any time after registration.

With respect to restrictions on the trading of registered traders, the proposed rule represents both an advance and a retreat on present rules. There is now to be instituted a flat prohibition on plus or zero plus tick purchases (at the offer) above the previous day's high. This replaces the more limited and very cumbersome present prohibition. However, the present "clarification" of Rule 110 comes into play at the previous day's closing price. Thus, the proposed rule may be more stringent in its restrictions but applies only when prices have moved above the previous day's high. The Exchange has never presented any analysis of the number of stocks which close above or below the day's high in various kinds of markets, nor have they made any analysis with respect to relationship of high and close to price trend. This change is merely tinkering with the apparent hope that the increased restriction is somewhat offset by the increased liberalization.

The other restrictions on trading, a performance test of 60% "stabilization", provides no major inhibition on floor trader activities. As we have previously pointed out, this so-called "tick test" does not necessarily measure stabilization.¹ Although this test may have some usefulness as a tool in evaluating performance, the level of 60% is set so low as to make it relatively useless. It should be noted that the Amex proposals which set the required "stabilization" rate at a level of 80% on the acquisition side and 70% in the liquidation of positions. These figures, while not wholly adequate, are much more restrictive than the NYSE rule. This is not only because the level is higher but because the acquisition and liquidation sides are computed separately. Under the NYSE test a floor trader can achieve 60% while averaging 80% on the acquisition side and 40% on the liquidation side, i.e., 60% of his liquidating transactions can be "destabilizing" in nature.

¹ See pages 101-105 in Part 2 of the Special Study Report analyzing the relationship between a "tick" and a price trend.

In two limited respects the proposed NYSE rules represent an improvement on the existing pattern of regulation. The definition of floor trading has been extended to catch some obvious evasions, e.g., a member entrusted with discretion by his firm in executing an order for the firm's trading account will now be governed by the floor trading rules as well as the situation where a member on the floor starts a sequence of events leading to a transaction by furnishing his office with an unsolicited quotation. Second, floor traders must now yield priority based on time to off-floor orders when they seek to establish a position.

It cannot reasonably be anticipated that these new restrictions in themselves, or as part of the overall regulatory pattern will have any substantial effect in solving the problems historically associated with floor trading. The new rules will not restrict floor trading to a small professional group whose activities are so restricted as to assure that only the limited "beneficial" aspects of floor trading are preserved. On the contrary, the new rules appear to represent an institutionalization of the presently existing system without impeding the present activities of most floor traders. Finally, it should be noted that the new proposals still fall short of the final Cresap proposals in 5 of the 6 areas noted on pages 8 and 9 of Mr. Frank's statement to the Commission on March 4, 1964.