

New York Stock Exchange  
New York, NY

October 3, 1967

The Honorable Manual F. Cohen  
Chairman  
Securities and Exchange Commission  
500 North Capitol Street, N. W.  
Washington, D. C. 20549

Dear Mr. Chairman;

Following the recent retirement of Keith Funston, I have reviewed the correspondence regarding our new Rule 394(b).

In your letter of June 9, 1967, you requested the views of the Exchange as to why member firms had made "minimal" use of the provisions of our new Rule 394(b). A survey was subsequently conducted to obtain the opinions and reactions of those member organizations who had used 394(b) the most often, and also of those who had no such transactions. The results of this study were sent to you on July 7.

Your reply indicated that the "minimal" use of the Rule is being attributed to the fact that member firms, in general, consider the making of inquiries of the several non-member market-makers registered in a given stock to be too time consuming when speed in the execution of orders is important. This has led to the suggestion that member firms first obtain bid and asked quotations from non-member market-makers thereby supposedly enabling & broker on the Floor to more quickly judge whether an "off-Floor" execution would be to his customer's advantage.

If a broker's experience indicates that satisfactory executions are usually obtained on the Floors he would not risk missing the market -- particularly by disclosing his order prematurely to the possible disadvantage of his customer -- and perhaps not giving his customer a desired prompt execution due to "shopping" the Street. Whether he does his shopping before or after representing his order on the Floor would make little difference in regard to the total time consumed. In actual practice, the crux of the matter is that a knowledgeable broker is well aware of what a satisfactory price for his order ought to be, based on the size of his order, the particular stock, and the current market. When he can receive this price on the Floor, he is further able to service his customer by promptly executing the order at that price.

As you know, this point regarding quotations was discussed before the Rule was adopted. We still feel that it is essential to obtain quotations after the primary market is contacted. We do not believe that the so-called "minimal" usage has any direct relationship to the fact that off-Floor quotations are obtained subsequent to, rather than before, on-Floor bids or offers. Since, as was pointed out in the course of discussion, there was no precedent of any kind for this Rule, it is difficult to determine on a comparison basis what might constitute a particular, or desirable, level of usage. Certainly, the Exchange never expected that Rule 394(b) would result in a significant shift of transactions to the Third Market.

Nevertheless, what was not taken fully into account was the factor of increased volume and activity on the Floor of the Exchange. This factor has apparently provided, in general, a market of such depth and closeness as to result in consistently satisfactory executions on the Floor. The significant increase in block transactions over the past two years, even as an increased percentage within the overall increased volume on the Exchange, is certainly an indication that the depth and liquidity of this primary marketplace well serves the public interest without resort to secondary markets. Specialists, with their available capital and their responsibility for the maintenance of fair and orderly markets, have been able to provide bids or offers for such orders to the extent that it frequently has become unnecessary to take the further step of contacting the Third Market. Further, the positioning activities of a number of member organizations make substantial additional capital available to service the primary market. Were the Third Market to be contacted first, any quotation received would be apt to be based in large measure upon the current quotation in the primary market here on the Floor of the Exchange. The market might, therefore, be missed whether or not Third Market quotations were solicited before or after the order was taken to the Floor of the Exchange.

In considering the execution of a block trade, the process of obtaining a quotation must, by its nature, involve a dialogue. Unless there is a full disclosure of the order the act is valueless, and would, therefore, have the practical result of revealing the order to the market-makers before it was even presented to the primary market.

Because of the primacy of the Exchange market, It was advocated during last year's discussions that Exchange members should have first access to such orders. Actually, of course, such an approach to the Exchange Floor may not be first at all. Third market dealers are constantly making bids and offers in listed stocks to the same institutional customers serviced by members. Therefore, it can be assumed that a decision to give an order to a member occurs only after the institutional customer has made the determination as to where the order might best be executed. Customers of the type dealing in the sort of large orders

here in question are knowledgeable enough to be continually aware of where they might best get an execution. Obviously, therefore, they would contact a non-member directly if they had any reason to believe a better price for that particular order could be obtained in the Third Market. Thus, not only are many orders which are being executed in the Third Market not included in the statistics applicable to the functioning of Rule 394(b) -- although they are in practice part of the same overall situation -- but also it is apparent that orders which do reach the Floor have at least an implied indication that the Third Market has already been considered to some degree.

Accordingly, we feel that the statistics and opinions contained in Mr. Funston's letter of July 7, indicate that the functioning of the Rule has provided ample opportunity for member firms to effect orders in the Third Market where desirable. You can well understand our pride in the liquidity and depth of the market on the Floor which we feel to be the heart of this matter. Anything less than the levels of performance experienced in the last several years might have different results. We feel that the time to consider any changes in the procedures under this Rule might well be when statistics indicate that a secondary market is needed to a much greater extent rather than under the present conditions.

We are, of course, willing to discuss this further if you so desire.

Sincerely,

Robert W. Haack  
President