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CHAIRMAN'S OFFICE  
MAILED

JUN 23 1978

Mr. William M. Batten  
Chairman  
New York Stock Exchange, Inc.  
11 Wall Street  
New York, NY 10005

Signed by: \_\_\_\_\_

Dear Mil:

As you will recall, in its January 1978 statement concerning development of a national market system, the Commission called for prompt development of comprehensive market linkage and order routing systems "to permit the efficient transmission of orders (i) among the various markets for qualified securities, whether on an exchange or over-the-counter . . . , (ii) and from brokers and dealers to all [such] markets." In particular, the Commission urged the self-regulatory organizations to

combine their efforts and take joint action forthwith in order to (i) make available to their members a single system for the prompt and efficient routing of orders for qualified securities from brokers and dealers' offices to any qualified market, and (ii) achieve a comprehensive linkage of all qualified markets in an efficient intermarket order routing system.

The Commission requested each self-regulatory organization to inform the Commission of its willingness to undertake development of these order routing and market linkage systems voluntarily and to submit to the Commission, by April 15, 1978, an agenda for their implementation.

With respect to market linkage, the New York ("NYSE"), American ("Amex"), Midwest, Pacific and Philadelphia Stock Exchanges suggested that implementation of the Intermarket Trading System ("ITS") would achieve an appropriate linkage of all competing market centers. The National Association of Securities Dealers, Inc. ("NASD") and the Cincinnati Stock Exchange ("CSE"), without commenting specifically on the ITS, suggested alternative proposals.

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Although the phased implementation of the ITS appears to be proceeding in a manner satisfactory to its present participants, there seem to be unresolved questions as to whether this particular system for linking competing markets represents a satisfactory solution of the problem of linking all such markets. The Commission continues to believe that, ultimately, all market centers for qualified securities must be linked in an appropriate manner in a national market system. Consequently, I would appreciate your advising the Commission of any factors (either technical or policy) which you believe bear on the feasibility or desirability of including over-the-counter market makers and the CSE in the ITS or of taking some other step or series of steps to insure an appropriate linkage of competing market centers. If you believe the ITS linkage would be a more appropriate or effective method of tying together competing market centers than other mechanisms which have been suggested (e.g., by the NASD or by the CSE), please explain the reasons for that belief.

With respect to the second component of the order routing package described in the Commission's January statement -- a universally available, neutral, "upstairs" message switch -- the Commission received two alternative proposals. The first, a proposal for a national order routing system, was contained in the submission by the NASD of a technical plan for the development of a national market system. As we understand the NASD proposal, it envisions that system as the primary means for routing orders to the various market centers and as the center of a communications network connecting all brokers, dealers and market centers. The second proposal was that made by the NYSE, and concurred in by the Amex, contemplating adaptation of the NYSE/Amex common message switch (currently providing order routing capability to the floors of those two exchanges) to provide the type of order routing capability referred to in the January statement. The NYSE/Amex proposal, however, contemplates the continued existence of multiple, competing switches (as opposed to the single system described in the Commission's January statement) and appears to assume that the modified NYSE/Amex common message switch would continue to handle only a relatively small percentage of total message traffic. In addition, unlike the NASD proposal, the NYSE and Amex do not contemplate modifying their common message switch

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in a manner which would permit computer-to-computer interfaces with automatic pricing systems maintained by certain market centers (e.g., Comex on the Pacific Stock Exchange and PACE on the Philadelphia Stock Exchange) or order-by-order routing decisions by users of the switch, i.e., a separate decision (either determined by the originating broker or by application of an algorithm to the switching facility) as to which of the several competing markets should receive a particular order, based upon price and size information disseminated pursuant to Rule 11Ac1-1 at the time the routing decision is made.

While the Commission appreciates the thought and work which went into the development of each of the proposals, we are somewhat disappointed that, in contrast to the cooperative and joint efforts evident in the development of the ITS, the self-regulatory organizations have proceeded independently, apparently without communicating with one another, in approaching the problem of improving "upstairs" order routing capability. We do, however, recognize that the timetable originally set in the January statement may have been too short to permit joint deliberation and action at this stage of the process. Nonetheless, unless the self-regulatory organizations are able to agree on a satisfactory approach, it appears that it may be necessary for the Commission to initiate additional action, including possible rulemaking, to resolve questions as to the direction which should be followed by all self-regulatory organizations in developing an appropriate routing and switching system.

In order to more fully assess the alternative methods of providing comprehensive, neutral "upstairs" order routing and switching facilities, and to explore ways in which the Commission can assist the industry in acting jointly in this area, the Commission believes it would be appropriate, in the near future, to convene one or more meetings involving the interested self-regulatory organizations to discuss these subjects. Prior to scheduling any such meeting, however, the Commission wishes to receive additional information regarding the implications of the proposals which have been advanced thus far. Accordingly, the Commission requests your comment on the following questions:

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1. Should the routing of orders by brokers, on an order-by-order basis, to the best market, in size, as determined by quotations made available pursuant to Rule 11Ac1-1 under the Exchange Act, be a characteristic of a national market system?

In answering this question, you should focus on the effects you believe order-by-order routing decisions would have on:

- (a) a broker's ability to achieve economically efficient execution of securities transactions;
  - (b) fair competition among brokers and dealers, among exchange markets, and between exchange markets and markets other than exchange markets; and
  - (c) the practicability of brokers executing investors' orders in the best market.
2. If the answer to question 1 is yes:

- (a) do you believe that efficient order-by-order routing capability can be achieved in the absence of a single, exclusive message switch, or do you believe that such capability can be made available on a satisfactory basis through separate, competing order routing systems? If you believe that separate order routing systems are feasible in this context, should any such system (whether offered by a self-regulatory organization, by a private vendor, or developed "in-house" by a broker-dealer) which either is (i) not "neutral" with respect to all market centers for qualified securities, or (ii) does not assure that brokers have available efficient order-by-order routing capability, be permitted to be used to transmit orders for qualified securities to any market center in a national market system?

- (b) do you believe that either the NASD or the NYSE/Amex proposal contemplates a message switch affording efficient order-by-order routing capability?

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In responding to this question, you should specify any assumptions which you believe should be made regarding:

- i. message traffic
  - ii. use of either system
    - A. for different types of orders
    - B. for orders whose size or price exceeds that disseminated pursuant to Rule 11Ac1-1
  - iii. other criteria which you believe may be appropriately applied in directing order flow.
3. If the answer to question 1 is no, please explain how you believe orders should be processed to assure that the national market system goals of providing increased opportunities for competition among and between market centers and best execution can and will be achieved?

We would appreciate receiving your views no later than August 1, 1978. Submissions in response to this request should be sent to George A. Fitzsimmons, Secretary of the Commission. All submissions should refer to File No. S7-735 and will be available for public inspection at the Commission's Public Reference Room.

Thank you for your cooperation.

For the Commission.

Sincerely,

Harold M. Williams  
Chairman

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Subj. Files 34-81

Box 25 Folder "New York Stock Exchange U. 31"