UNITED STATES OF AMERICA
**COMMODITY FUTURES TRADING COMMISSION**
2033 K Street, N.W.
Washington, D.C. 20581

April 1, 1988

Mr. Jonathan G. Katz
Secretary
Securities & Exchange Commission
450 5th Street, N.W.
Washington, D.C. 20549

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Dear Mr. Katz:

This is response to the Securities & Exchange Commission's request for comment on proposed new rule 80A of the New York Stock Exchange (NYSE) relating to index arbitrage [Filed No. SR-NYSE-88-02]. That rule and accompanying interpretation would prohibit the use of any of the automated order routing or trading facilities of the NYSE for orders or any other trading interest involving index arbitrage at those times that the Dow Jones Industrial Average reaches a value 50 or more points above or below the previous day's closing value. Exceptions to the rule include (a) orders transmitted but not executed prior to the time when the trigger point is reached, (b) market-on-close orders transmitted on the Friday (or, if Friday is a holiday, the next preceeding business day) when that day is the last trading day of any derivative index product [1/] and (c) in such cases as the NYSE waives the rule in "appropriate circumstances." Further, the Commodity Futures Trading Commission (Commission) understands that the NYSE has amended its original submission to provide that the rule would be placed into effect on a pilot basis for six months.

The Commission notes in particular that the proposed restriction applies only to index arbitrage trades, as that term is defined in the proposed rule and interpretation. While the Commission understands the NYSE's desire to diminish or eliminate volatility on that exchange and to restore investor confidence, it believes that arbitrage transactions are typically price neutral since they involve concurrent offsetting buy and sell orders. The Commission also believes that such transactions constitute an efficient and direct linkage between the equity market and derivative markets. In that context, the Report of the Presidential Task Force on Market Mechanisms notes that disconnection of the stock and stock index futures markets during the recent October market break exacerbated the rate of market

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[1/] This exception would not apply to market-on-close orders on Thursdays for securities traded in conjunction with derivative index products where the value is determined by the Friday opening stock prices.

decline and generally contributed to unsatisfactory market performance.[2]

The Commission understands in light of the events of October 1987 the necessity of the NYSE to take timely action with respect to any trading rules which it believes will diminish unwarranted price volatility. However, the Commission is concerned that when viewed from a longer term perspective, the proposed rule may not be consistent with the concept of a coordinated intermarket response to periods of increased price volatility. In view of the potential adverse market implications of a rule which may substantially diminish the linkage between the stock market and derivative index markets, the Commission believes that alternative longer term solutions to questions of intermarket coordination need further exploration both among securities and futures exchanges and in the federal sector. An appropriate forum for considering longer term solutions, of course, is the Working Group on Financial Markets recently established by President Reagan as well as the ongoing discussions between our agencies.

Sincerely,

Jean A. Webb

Jean A. Webb
Secretary of the Commission

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[2]/Pages 36, 42, and 56.