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October 6, 1977

Chairman Harold M. Williams
Securities and Exchange Commission
500 North Capitol Street, N.W.
Washington, D.C. 20549

Dear Chairman Williams:

As we discussed when you were in Chicago recently, the Midwest Stock Exchange, Incorporated ("Midwest") is very concerned about the manner in which the Commission has handled various proposed rule changes affecting Midwest's options market. Although we have informally expressed this concern to both you and members of the staff, I believe it is now appropriate to raise the matter formally with the Commission and to request prompt Commission action on one pending rule change of great importance to the current operation and future success of the Midwest options program.

Specifically, Midwest requests the Commission to approve a proposed rule change (SR-MSE-77-2) as amended by Amendment No. 1 mailed on May 9, 1977 (the "Proposed Rule Change"), which would modify the intervals at which exercise prices are set on options for securities trading for less than $100 per share. Under the proposed modification, intervals for exercise prices would be fixed at 2 1/2 points for securities trading below $25, and at 5 points for securities trading between $25 and $100.

The Proposed Rule Change was mailed to the Commission on February 22, 1977, and published for comments in the Federal Register on March 23, 1977. As you know, under Section 19(b) of the Securities Exchange Act of 1934 ("the Act"), within 90 days of the date of publication of a proposed rule change the Commission must either approve the rule change or "institute proceedings to determine whether the proposed rule change should be disapproved." Nevertheless, although Midwest has not consented to an extension of time beyond this 90 day period, the Commission has not yet acted on the Proposed Rule Change. Thus, despite a clear statutory mandate to the contrary, the Commission has delayed action on this important matter for more than 6 months.

The Commission's refusal to abide by the requirements of the Act is, in our view, not only unjustified but unlawful. The precise timetables for Commission action on rule changes of self-regulatory organizations were added to the Act by the Securities Acts Amendments of 1975. They were the subject of intense negotiation between the Congress, the industry and the Commission, and their adoption in their present form reflected the Congress' conclusion that the self-regulatory organizations were entitled to definitive Commission action on their proposed rule changes within a reasonable period of time. By failing to follow the statutory procedure, the Commission, in our view, is undermining the carefully designed scheme of cooperative regulation with the self-regulatory organizations, and it is, in effect, attempting to substitute its judgment for that of the Congress with respect to the proper procedure for processing self-regulatory rule changes.

The Commission's action on the Proposed Rule Change is more than a matter of academic interest to Midwest. As the youngest and smallest options exchange, Midwest faces a difficult and precarious competitive future. To remain viable, Midwest must be able to attract both members and order flow. To do this, it must be able to respond promptly and effectively to changing market conditions and investor interests. The proposed modification of strike price intervals is precisely the type of operational change that is essential for healthy development of the Midwest market, for the change will increase spreading and hedging opportunities for Midwest market makers thereby increasing the liquidity of the market, decreasing the risk to market makers of carrying sizable positions, and enabling market makers to quote tighter markets. Public investors will thus have increased access to narrow, continuous, two-sided markets, as well as more attractive investment opportunities. Accordingly, we request the Commission promptly to approve the Proposed Rule Change.

Although it is impossible to predict the amount of additional transaction volume that will result from the implementation of the modified strike prices, our preliminary projections do indicate that there will be a positive impact on the Midwest options market. This increased volume will be beneficial to our market makers and public investors. The increased transaction volume will also impact favorably on Midwest's financial position and may help to alleviate the significant cost burden that the options operation has imposed.

After the long delay in the processing of the Proposed Rule Change and in light of its importance to the Midwest options market, we can see no justification at this stage for either further delay in its approval or the institution of a disapproval proceeding. We are, of course, aware of the so-called "options moratorium" that the Commission requested on July 18, 1977. However, we do not believe that the "moratorium" provides a justification for the Commission's failure to process self-regulatory rule changes in strict compliance with statutory procedures. Of course, if the reasons underlying the requested "moratorium" suggest that the Proposed Rule Change -- or any other proposed rule change of a self-regulatory organization -- may not be consistent with the requirements of the Act, then we believe that those reasons should be publicly articulated by the Commission, and a hearing held in accordance with Section 19(b)(2)(B). Nevertheless, in this case we are not aware of any connection between the subject matter of the

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Proposed Rule Change and the types of concerns that purportedly led to the requested "moratorium".

In recent weeks, the securities trade press has reported comments by sources reportedly at the Commission and within the industry to the effect that Midwest would be best advised not to press the Commission for formal action on the Proposed Rule Change. One argument has been that by doing so, Midwest would force the Commission publicly to identify serious shortcomings in the operation and regulation of the options market, thereby possibly undermining investor confidence. It has also been argued that by demanding formal Commission action, much of the flexibility in the present options "moratorium" would be lost and Midwest and the other exchanges might be "worse off" than they are at present.

We find these arguments extremely disturbing, and we believe it is time they were answered once and for all. We have no doubt that if the Commission were aware of serious shortcomings in the operation or regulation of the options markets, it would, given its obligations to both public investors and the self-regulatory organizations, identify those shortcomings promptly and with as much specificity as possible. Not to identify such shortcomings would be to expose investors to unnecessary risks and self-regulatory organizations to possibly unrealized liabilities. As for losing the flexibility inherent in the current informal "moratorium," we believe that the scheme of cooperative regulation specified in the Act defines the proper balance between the Commission's power and responsibility and those of the self-regulatory organizations. The sound course, in our view, is for the Commission and the self-regulatory organizations both to adhere, in good faith, to the statutory procedures and to avoid to the maximum degree possible ad hoc directives and informal requests for modified procedures.

In light of the extreme delay that has already occurred in the processing of the Proposed Rule Change, the importance of that rule change to the success of the Midwest options market, and the lack of any basis of which we are aware for disapproving it, Midwest requests that the Commission approve the Proposed Rule Change as quickly as possible, but in no event later than the end of next week.

Sincerely,

Michael E. Tobin
President

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CC: Commissioner Philip A. Loomis, Jr.
Commissioner John R. Evans
Commissioner Irving M. Pollack
Commissioner Roberta S. Karmel