

February 26, 1988

Mr. Richard G. Ketchum  
Director  
Division of Market Regulation  
Securities and Exchange Commission  
Washington, D.C. 20549

Dear Rick:

This letter is in response to your letter of February 12 concerning items meriting further review identified in The October 1987 Market Break Study.

At the outset, I would like to compliment the Commission's staff on its excellent and well-balanced study. We consider the issues raised in the study and in your recent letter to be of the highest priority. To that end, the Exchange has discussed with Chairman Ruder the creation of a joint task force of Exchange and SEC staff to immediately commence work on addressing those areas in the SEC study which fall under our jurisdiction.

Before I begin to address each of the sixteen items listed in your letter, let me speak to some of the "common themes" which you mentioned. As you know, a key Exchange initiative was the creation of the Operations Advisory Committee which meets several times each week. Attached is a list of the members of the committee. The objective of the committee is to ensure that the Exchange and the member firm community synchronize their planning and operational efforts to provide the capacity to routinely handle a 600 million share day. Specifically, the short term goal is to ensure both the industry and the Exchange can function on the next 600 million share day as effectively as it does on a 225 million share day. Our intermediate objective (1989) is to be prepared for the first billion share day.

Regarding the need for better information sharing and coordination among self-regulatory organizations (SRO), the Exchange is pursuing several initiatives. The heads of SRO's met at the Exchange on January 11 (Attachment B) to discuss methods of improving communications. A meeting of all exchanges (equities and derivatives) was held in New York on February 24th to work toward that goal. Similarly, we recognize the need for more effective communication relating to system delays, both from marketplaces and the brokerage community. We will work to ensure that objective through the efforts of our Operations Advisory Committee.

You asked for our thoughts concerning market basket trading, derivative product leverage, price limits, short-sale restrictions and enhanced reporting requirements. These are obviously extremely important issues and we plan to review them and as soon as determinations have been reached, we will communicate our positions to the Commission.

In order to respond to each of your items clearly, each one is addressed separately except three areas where the questions are closely connected and deserve a combined answer.

1. Develop relative, objective standards for evaluating specialist performance.

The development of additional specialist performance standards utilizing objective measures is currently being undertaken by the Exchange. We have previously filed with the Commission a new job description of expected specialist performance as well as a greatly expanded program under Exchange Rule 103A which, if approved, will implement specific objective standards in the areas of specialists' DOT order handling and reporting, timely opening of securities, handling of administrative message traffic and others.

Relative standards present a more difficult question. As you know, we have examined this issue and discussed it extensively with the Commission over the years. Nevertheless, we will reexamine the feasibility and desirability of such standards.

2. Examine individual specialist performance for the period of the market break Particularly:

3. Bring disciplinary actions or reallocation proceedings to remedy poor specialist performance during the market break.

The Exchange has already reallocated the stocks of J.P. Morgan & Co. and Gould, Inc.; and we are presently in the process of reallocating Neiman-Marcus Group, E. F. Hutton Group, Inc., A. G. Edwards, Inc. and Carter-Wallace, Inc. All of these reallocations are a result of our examination of specialist performance during the October market break.

The Exchange's Market Surveillance Division is continuing to review specialist activity during the October market break period with special reference to those areas delineated above.

4. Review minimum capital requirements for specialists;

5. Review present systems of specialist capital surveillance to determine if increased monitoring is necessary; and

7. Require all "self-clearing" specialists to maintain line of credit

The Exchange is presently engaged in a full-scale review of specialists' capital requirements. As an integral part of this review, we are exploring the need for specialists

to maintain additional lines of credit and other lending arrangements. We will keep the Commission informed of our progress and, upon completion of our review, our recommendations in this area.

The Exchange has increased its monitoring of both specialists' capital and positions by requiring that such information be filed with the Exchange daily, by 9:00 a.m..

6. Establishment of diverse lending relationships.

The Exchange staff will, over the next several weeks, meet with a number of its largest member firms to discuss their credit and banking arrangements, including the number of banking relationships, the type of such relationships and their activities in obtaining other financing.

8. Accelerate efforts to generate same-day compared trades.

The Operations Advisory Committee will address a shortened comparison cycle as well as automation of the Questioned Trade (QT) process.

The Exchange has a continuing effort to improve its comparison systems. These efforts have involved the National Securities Clearing Corporation (NSCC), the Securities Industry Automation Corporation (SIAC) and the member firm community. Today, with the combination of automated systems and omnibus clearing accounts approximately 70 percent of all NYSE trades are locked-in and compared by the next morning. The Exchange expects to increase the number of locked-in and compared trades through further expansion of its automated systems.

The NYSE has also initiated a project known as Floor Derived Comparison (FDC) which is designed to reduce the period of time required to compare any NYSE trade. An element of this program involves reducing the period for presentation of uncomparing trades from the third to second day after trade date.

9. Improvement of Order Processing.

Since the week of October 19, 1987, improvements have been made to virtually every Exchange system. These improvements corrected problems experienced during that period and in many instances improved the Exchange's overall processing capabilities, and are as follows:

- o In November 1987, the DOT's system memory was increased and several of the system's data files were separated to allow more efficient processing. Further system enhancements are scheduled to be completed by July 1988 to improve DOT's processing capability even more.
- o In January 1988, program changes were completed in the Limit Order System to reduce system bottlenecks discovered during the October market break. A major

upgrade of the system with more efficient computers is targeted for April 1988 and is expected to result in a 50 percent increase in capacity.

- The NYSE had begun to replace its odd-lot system prior to October 1987. This new odd-lot system was fully operational on February 22, 1988.
- The ability of the NYSE's Universal Floor Device Controller to store and process data has been increased. To add additional capacity, major portions of data normally routed through the Universal Floor Device Controller will be re-routed to other systems over the next three months.
- The capacity of the NYSE's Post Support System to store and process orders has been increased through the use of additional computer power for the system.
- Enhancements in the NYSE's Universal Floor Controller and its printers that currently are underway will reduce the potential for delays in the Exchange's link with the Intermarket Trading System.
- As of November 1987, the computers running the Consolidated Tape System have been replaced. As a result, the system now has the capacity to efficiently process a peak volume of 600 million shares.
- Computer enhancements were made to the As-Of-Status-System on October 24th, and 25th, 1987, and we believe the problem has now been solved.

Listed below are all the Exchange's systems, the highest level of traffic experienced, current message per second capacity, and our mid and year-end capacity goals.

<u>System</u>	<u>Peak Experienced</u>	<u>Current Capacity</u>	<u>Mid/Year Cap.</u>	<u>Y/E Cap.</u>
Common Message Switch	80	95	105	140
Limit Order System	26	40	60	60
Market Order System	53	53+	70	80+
Post Support System	44	60	75	100
Universal Floor Device Controller	68+	68	68	50
Intermarket Trading System	5	7	7	7
DOT For Options	3	8	8	8
Consolidated Quote System	27	33	33	33
Consolidated Tape System	17	24	30	40
Market Data System	23	60	60	60
Information Generation System	72	100	100	130

On January 18, 1988 the Exchange opened its Expanded Blue Room, which added approximately 20 percent to our trading facilities. This new facility includes two and

one-half trading posts and associated equipment and allows for a significant redistribution of trading activity. The additional equipment will also significantly reduce burdens placed on printer devices during the week of October 19. We also plan to install an additional high speed printer at each post. Additionally, we will continue to investigate methods to double the speed of the existing printers on the trading floor.

The Exchange has also continued implementation of electronic display books. The number of display books has been increased over 25 percent and the number of stocks on display books more than doubled since October 19th. By the end of 1988 current plans call for over 400 display books handling 75 percent of system orders.

10-14. Intermarket Trading System (ITS) Efforts.

Since its inception in 1978, the NYSE has demonstrated a major commitment to the Intermarket Trading System (ITS). The events of October 19 and 20 have raised several questions about the functioning of ITS in high volume and what steps might be taken to address the questions. The Exchange is committed to resolving all problems associated with ITS experienced during the high volume.

With regard to separating ITS terminals from the printing functions of other NYSE systems, the Exchange does not believe it is necessary to take such an action. As previously explained, the Exchange has inaugurated steps to route DOT and Limit order traffic to the Electronic Books via a new communication switch, thus significantly freeing up capacity in the Universal Floor Device Controller.

Effectively then, ITS commitments will not be competing with order traffic. Additionally, since October 19, the Exchange has been adding display books and adding stocks to the existing display books to handle SuperDOT traffic. These efforts further eliminate printer functions for SuperDOT. Additional printers and decentralized routing, will be available in high demand situations. These efforts will effectively leave the post printers for ITS functions, and, we believe, respond to the concerns without the need to create another path for ITS delivery, which may be less efficient.

We are confident that our plans for systems enhancements will permit ITS commitments to print prior to expiration. We believe that had the enhancements been in place prior to October 19, the ITS queueing and printing problems would not have occurred. For these reasons, we think these actions eliminate the need for considering a default procedure.

With regard to the issue of Intermarket Pre Opening procedures after trading halt imbalances, the Exchange will initiate a proposal to implement such procedures. We would welcome the staff's guidance as to whether all ITS participants, or only those who have halted trading should be included in that process.

Communication among all marketplaces is a key issue for following the events of October. This issue was discussed at the ITS Operating Committee meeting last week. The Committee has identified each Operating Committee member as the key ITS contact

person. Each key contact will designate an alternative and communicate that to the other participants. Additionally, each Exchange participant will provide names and phone numbers for key members familiar with ITS operation and policy. Communication procedures will be established, particularly during market emergencies.

The handling of complaints is important to the Exchange. The changes in system configuration should address most causes for complaints experienced during October. It is our intention to cross train our staff to be prepared to address problems in overload situations. We feel these additional resources coupled with our system initiatives will assist in investigation and resolution of all ITS problems.

15. Review of Trade and Quotes Reporting Capabilities during periods of sustained high volume

The Exchange believes that the trade and quote reporting during the events of October was up-to-date and reliable. In stocks where additional help was required, additional staff members were assigned to those stocks. In recent years, we have developed and maintained qualified off-Floor staff members as reporters in our Emergency Reserve Program. Those staff members provided trade and quote reporting during the week of October 19 and the November work interruption. We are committed to ensure accurate trade and quote reporting no matter what level of activity we experience.

16. Review of operational capacity of firms' order handling systems

The Exchange's Operations Advisory Committee plans to establish operational standards to be applied to all market participants.

Finally, we would like to reemphasize our commitment to continuing our open dialogue with the Commission on the issues outlined above and hope we can meet in the very near future to review our plans and progress on these items.

If you or your staff have any questions, please contact me.

Sincerely,

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