NEWS

SECURITIES AND EXCHANGE COMMISSION
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COMMISSION STUDY EXAMINES OPERATION OF THE NATIONAL SECURITIES TRADING SYSTEM

The Commission today issued a second monitoring report examining progress by the securities industry in developing facilities to reach National Market System objectives. The report, prepared by the Directorate of Economic and Policy Analysis, focuses on the Cincinnati Stock Exchange National Securities Trading System (NSTS) and examines, among other things, quality of executions and the impact on the primary market for dually-traded securities.

The NSTS commenced operation in June 1978 with 38 stocks designated for trading. Since the inception of the NSTS, the number of NSTS Stocks has remained relatively stable, but increased from 41 to 49 during 1980.

In June 1978, total NSTS share volume was 533,000 shares. Volume expanded to 2,394,000 shares (4,850 trades) in December 1979 and to 4,006,000 shares (13,700 trades) in December 1980. During 1980, NSTS share volume accounted for 1.8 percent of composite share volume in NSTS Stocks; however, in the ten most active NSTS Stocks, NSTS accounted for 6.1 percent of composite share volume during this period.

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Only a few firms have been active in the NSTS. From the standpoint of use of the NSTS, the most important participants are the five upstairs approved dealers, that is, participants who enter orders by means of computer terminals located in their own offices; these participants accounted for about 97 percent of NSTS share volume during 1980. Moreover, Merrill Lynch, Pierce, Fenner & Smith Inc., the largest upstairs approved dealer, accounted for about 75 percent of NSTS share volume during the year.

The report also shows the extent to which upstairs approved dealers transact directly with their customers on a principal basis or cross their customers' orders with each other in the NSTS. It was found that agency crosses accounted for 25 percent of NSTS agency share volume during four sample weeks in 1980, and principal transactions by upstairs approved dealers with their customers accounted for 63 percent of NSTS agency share volume during this sample period. These percentages primarily reflect the trading activity of the two most active upstairs participants (Merrill Lynch and Moseley, Hallgarten, Estabrook and Weeden), which account for a substantial portion of NSTS volume. The minimal use of the NSTS by other participants has apparently limited the opportunity for order interaction in the NSTS.

The report also examines the quality of NSTS executions and the impact of the NSTS on the quality of the primary market. By comparing NSTS executions with contemporaneous prices and quotations in the primary market, the study found that NSTS executions occur only infrequently at prices outside the contemporaneous quotations of the New York Stock Exchange.

The report also analyzed the impact of the NSTS on the quality of the primary market by means of statistical techniques. One statistical model detected no effect on the quality of the primary market; however, another model which included the percent of composite volume executed in the NSTS found that increased trading of a given security in the NSTS may have a very slight narrowing effect on its NYSE spread. The statistical results presented in the report must be considered tentative in view of the limited scope of the experiment, both in terms of the paucity of issues actively traded and the limited number of active participants in the NSTS.

The NSTS is intended by its sponsor to be a component of the National Market System mandated by the Congress in 1975. The NSTS consists of a fully automated electronic trading system linking upstairs dealers and brokers and certain regional exchange specialists.

The NSTS enables Cincinnati Stock Exchange ("CSE") members, without the necessity of maintaining a presence on the floor of the CSE or any other exchange, to participate in the system by entering into computer terminals bids and offers for securities for their own account and as agent for their customers' accounts. In addition, a specialist on the floor of an exchange linked to the NSTS can enter bids and offers into the system as principal or as agent for any security designated as eligible to be traded in the NSTS for which the specialist is registered on that exchange.

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