



SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C. 20549

March 18, 1964

Mr. Keith Funston, President  
Mr. Henry M. Watts, Jr.,  
Chairman of the Board  
New York Stock Exchange  
Eleven Wall Street  
New York 5, New York

Gentlemen:

We are deeply concerned by the impasse in staff discussions concerning the Exchange's use of the EDU<sup>2</sup> equipment now to be installed.

It appears that the equipment is capable of serving as an almost indispensable tool in helping the Exchange and the Commission to meet their respective statutory responsibilities. Yet the equipment is not being applied to full advantage nor has the Exchange given any serious consideration to such application.

The need for the Exchange to use automated techniques for market surveillance was originally given a high priority in the program for implementation of the Special Study's recommendations. Since that time the activities of some members on November 22 have confirmed the need for the Exchange to employ the most effective methods available to detect violation of its rules. Surely there can be no room for question on this score.

We understand that the present stalemate is created by the Exchange's failure to take a first step essential to using its new automated equipment for surveillance purposes. That step is the capture and retention of certain basic transaction data, primarily the identity of members participating as principals. The desired data for each transaction were summarized in Mr. Ralph Saul's letter to Mr. Funston of December 10, 1963 as follows:

- a. identification of underlying brokers on both sides;
- b. indication of whether principal is a nonmember, specialist, floor trader, odd-lot dealer or member off-floor;
- c. whether sale is long, short or short exempt;
- d. whether execution is by the specialist as agent;
- e. identification of executing brokers;
- f. purchases to cover short positions;
- g. type of order.

Though this letter stressed the importance of the first four items, it requested "specific advice" concerning the Exchange's plans for capture of all of them. Your letter of December 17 was not responsive, however, to this request and did not furnish the advice the Commission was seeking.

The input of these transaction data, together with development of appropriate computer programs, would secure some far-reaching benefits:

- 1) Fundamental improvement in the Exchange's surveillance of trading activities. Capture and input of these data will permit prompt and accurate determination of whether members are complying with or violating the Exchange's rules.
- 2) Substantial enlargement of the Commission's ability to carry out its oversight responsibilities and to enforce the securities laws and its own rules.
- 3) Replacement of present archaic quill-type and admittedly incomplete reports with accurate, complete data. This will open up new avenues for securing more comprehensive and useful data in the future.

We realize that the Exchange's present automation program has been underway for some time and that it did not contemplate these objectives. But in view of the basic importance of these goals, we cannot understand your reluctance to reassess the immediate program and to adapt it for broader public purposes.

On February 17, Exchange representatives advised the Commission staff that the Exchange was increasing the capabilities of the EDP equipment now on order. They made it clear that the change was for purposes other than those requested by the Commission, although it can apparently serve such purposes as well.

It was also made clear that the Exchange is prepared to do nothing to meet the Commission's request at this time; that the Exchange's Board of Governors has set no goals for the use of the present automated installation other than its original limited objectives; that members of the Exchange staff directly concerned with floor procedures have not participated actively in the Exchange's limited consideration of the Commission's request; and that the Exchange staff currently sees, under present schedules, no opportunity even to begin serious consideration of that request before the middle of 1965.

This is a wholly unsatisfactory situation. We do not underestimate the complexity of these problems. Nor do we believe that they are capable of overnight solution and implementation. But we do not understand them to be insoluble and cannot understand why, in view of the unquestionable importance of the goals, the Exchange should not be committed to a program of activity aimed at achieving them as promptly as is practical and reasonable.

It is imperative that the Exchange come to grips with this problem. We recommend the following steps:

The Exchange should adopt an official position with respect to use of modern automated procedures to discharge its statutory responsibilities. We assume there is no disagreement in principle concerning the need to capture the information described above, but it remains for the Board of Governors to state and announce its policy in this area. The Exchange should then authorize the measures needed for solving the problems of floor procedure, systems design, and computer programming. The need is not alone for articulation of goals but for practical measures to achieve them. I understand, in this connection, that the Commission staff has given the Exchange the benefit of some of its thinking in this area and has offered to consult with and to assist the Exchange.

Beyond the important immediate surveillance objectives, there is urgent and increasing need for the Exchange to establish these objectives as part of a long-range plan for the use of its EDP equipment. Such a plan would provide, of course, for expanding utilization of modern automated procedures in performance of the Exchange's surveillance and other responsibilities. Despite the reference in your letter of February 6 to the start of such a plan, it has not been communicated to us and, so far as we know, has never been reduced to writing. An acceptable long-range plan should now be formulated and publicly announced.

The Exchange's plan should provide for a basis for integrated data processing to assure maximum compatibility of automated systems within the industry. The achievement of such compatibility would appear to require coordination of the use of automated equipment by the exchanges,

public commission houses, odd lot firms, the Commission, and other interested parties. Procedures should be instituted to insure communication among those whose activities are so interrelated and we propose to arrange for a meeting at an early date to discuss such procedures.

We would like the Board of Governors to direct its attention to this matter and to give us its views at the earliest possible date. For that reason, I am enclosing extra copies of this letter for distribution to them.

Very truly yours,

*William L. Cary*

William L. Cary  
Chairman