

FACILITIES AND SYSTEMS COMMITTEE
March 2, 1976

There was a meeting of the Facilities and Systems Committee on Tuesday, March 2, 1976 at 3:30 P. M. The following committee members were present:

Richard Carrigan, Chairman	Butch McGuire
George Bokios	John Mitsch
Bill Finerman	Ralph Peters
Sheldon Goodman	Russ Ruhl
Dave Johnson	Don Small
Howard Katz	Robert Soukup
Ron Klipp	Dick Cowles, Staff
Gary Knoblauch	Ed Davis, Staff

Also present were Jerry Tellefsen of Booz Allen & Hamilton, Dave Hatcher, Phil Slocum and Rose Merrill, Staff. Steve Givot, Scott Nolan and Gerald Wood were unable to attend. Dr. James Lorie, member of the Board, attended as a guest speaker.

As part of its efforts to gain a more comprehensive understanding of all issues pertinent to AutoBook, the Committee had an opportunity to devote the entire meeting to a wide-ranging discussion with Dr. James Lorie. The emphasis of this session was on the economic, legislative, and regulatory forces that are reshaping the securities industry; the potential impact of these developments on the CBOE; and the potential strategies available to the CBOE in response to these trends.

Dr. Lorie reviewed the history leading up to Congress's mandate last year for a National Market System and discussed the basic elements of such a system as reflected in the 1975 legislation, actions of the SEC, and the deliberations of the National Market Advisory Board (of which he is a member). As for the potential impact of these developments on the CBOE, Dr. Lorie stressed that the emphasis of public policy is to bring about more competition in the securities industry and that by this criterion the CBOE is doing admirably. Cited by Dr. Lorie were our exchange's removal of fixed rates, avoidance of exclusionary practices, and, above all, the competing market maker system.

In particular the Committee sought advice and counsel from Dr. Lorie on how best to pattern the CBOE's market in order to strengthen the exchange's leadership in options. In Dr. Lorie's view, competition in the form of dual-listing is probably inevitable and may be prevalent by next year. In such an environment the exchange that prospers will be the one that offers perceptibly better service to the public investor. Thus, the pressure for a system such as AutoBook is likely to arise, not from regulatory actions, but as a natural result of competition.

With the SEC currently viewing development of a common limit order book as necessary to the achievement of a central market system, the discussion then turned to the implications of this objective for options and for the AutoBook effort. Dr. Lorie reported that the consensus of most commentators before the NMAB was that such a nationwide system would take three to four years to achieve, and that these estimates were predicated on a relatively modest system (limited access points and, certainly, no "automatic" execution function). He further pointed out that the current discussions regarding such a system were centered on its use for listed equities and that its application to the options market was problematic.

On a related question dealing with the potential inequities that could arise if a common book for options could be accessed by Amex specialists and CBOE competing market makers, Dr. Lorie stressed that any such access would have to be on an equal basis.

Turning to the larger question of automatic execution of trades by a computer, Dr. Lorie made a critical distinction between the tasks of a trader that require talent, judgment, and discretion and those that are clerical and repetitive. While the computer may be well suited to the latter, it would be a flop at the former. He went on to characterize the options market as probably the most complicated market in the world and certainly one requiring a relatively high degree of talent, judgment, and discretion to effectively trade options (especially with puts due to come on). On that basis the computer is likely to displace far less of an options trader's function than would be the case on the NYSE where upwards of 55% of the executions involve orders of 100 shares or less. However, a shift of simple repetitive tasks to a computer could result in short-run dislocations that could disadvantage some members (such as bypassing floor brokers with orders to be booked), but in the long run should work to the advantage of the exchange if such systems help produce a more efficient marketplace and thereby attract a greater flow of public orders.

In considering ways to computerize clerical functions that support trading Dr. Lorie also suggested that the most sensible route would be to move in relatively small steps, but in a fashion that permitted subsequent steps. Such an evolutionary approach should help maintain the flexibility required in light of the newness of our market and the underlying unpredictability of future developments in the securities industry.

In conclusion Dr. Lorie stated that, above all, the enlightened self-interest of the membership requires that any actions by this Committee or the Exchange should be considered from the standpoint of what is in the public interest.