

**THE** New York Stock  
**Exchange**John J. Phelan, Jr.  
Vice ChairmanMr. Gordon Macklin  
President  
National Association of  
Securities Dealers, Inc.  
1735 K. Street, N.W.  
Washington, D.C. 20006

August 10, 1979

Dear Gordon:

The purpose of this letter is twofold: first, to outline, as you have requested, our view of the open items which exist in connection with the proposed six-month pilot program for NASD participation in the Intermarket Trading System; and, second, to outline the essential features of the competitive market-maker system we are developing.

As we have repeatedly stressed, there has been no change in NYSE policy with respect to the desirability of NASD participation in ITS. We continue to believe that it is important for over-the-counter market-makers to be linked to ITS. The key question, as we see it, is whether this can best be accomplished through the proposed six-month pilot program that we have been discussing over the past several months, or through our projected competitive market-maker system.

I also should stress that the following list of open items relating to NASD participation in ITS reflect only the views of the New York Stock Exchange. We are not speaking for any other ITS participants in these comments.

Outline of NASD-ITS Pilot Open Items

1. ITS Quote Concentrator - In order for the NASD to comply with the ITS Plan requirement that the "best" quote be displayed, it is necessary to aggregate the various third market-maker quotations into an

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NASD "best" quote for display on the floors of the ITS participating market centers. It has been estimated that such a facility will cost about \$100,000, require approximately six months to build and result in approximately \$8,000 of monthly operating costs. While we are willing to assist in financing the quote concentrator, we do not think we should be expected to pay the entire cost and monthly operating expenses.

2. Off-Board Trading Rules - The off-board trading rules presently prohibit an Exchange member from trading as principal in the over-the-counter market. Accordingly, it may be necessary to amend or revise these rules to permit members to send principal commitments to over-the-counter participants in ITS.

3. Pilot Entry - The proposed NASD entry into ITS contemplates a six-month pilot period utilizing an NASD Service Center where incoming commitments can be received, outgoing commitments sent and responses/reports generated. It is our understanding that the NASD may do away with the Service Center after the pilot period and seek direct computer-to-computer access between ITS and NASDAQ. This issue may not relate directly to the six-month NASD pilot; however, in view of interest in computer-to-computer access expressed by the Pacific and Philadelphia Exchanges -- and the recently announced NASD automation plans -- we are currently studying the ramifications of this issue.

4. NASD Rules - We understand that a number of NASD rules have to be amended to assure compliance with the ITS Plan. To our knowledge, these NASD rule changes have not yet been made.

5. NASD Market-Maker Agreement - We also understand that the NASD is drafting an agreement which each market-maker would sign with the NASD binding the firm to the ITS Plan and NASD rules. Such agreements are especially important in the area of comparison and settlement. Again, to our knowledge, the form or text of this agreement has not yet been finalized.

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6. Draft of ITS Plan - Certain additional issues raised by the latest draft of the ITS Plan need to be discussed; but these issues, to our knowledge, do not appear to present major problems.

NYSE Competitive Market-Maker System

We are currently discussing, but have not finalized, the details of the competitive market-maker system discussed in our testimony at the SEC hearings on June 29.

The following outline summarizes the current details of this system relating to participation by market-makers who are not Exchange members:

1. The purpose of the system is to provide an efficient, cost-effective means for dealers to make competitive markets in listed stocks and, thus, strengthen competition in the pricing of listed stocks and provide a means by which more capital could be applied to the market-making function.
2. The system would be inaugurated with a pilot program involving about ten firms -- which could include five member and five non-member organizations.
3. The pilot could begin by late 1979 or early 1980 and would involve five to ten NYSE listed stocks.
4. Quotes from firms participating in the pilot would be displayed on the NYSE trading floor in the following manner:
  - a) Dealer bids and offers would be entered directly from the office of the participating market-maker via a keyboard/CRT.
  - b) Once entered, the dealer bid and offer would become part of the overall NYSE quotation that is disseminated over the Composite Quote System; and
  - c) Special display screens, both in the participating market-maker's office and at the post on the trading floor, would highlight that portion of the total NYSE quotation represented by the bid and/or offer of the participating market-maker.

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5. Thus, the non-member quote would be integrated in the ITS system, and any broker in an ITS participating market-center could hit a bid or take the offer of a participating non-member market-maker.

6. Executions against the participating market-maker's quote will take place on the NYSE trading floor as if the firm were physically represented in the trading crowd.

7. These executions would be immediately reported on the tape, as are other trades on the NYSE floor, and reported directly back to the participating market-maker.

8. Thus, the quotes of the participating market-maker would be "firm", as are similar quotes in the trading crowd.

9. If the bid of a participating market-maker "locks" or "equals" the offer on the floor, or the offer of another participating market-maker off the floor, an execution report would be sent to both participating market-makers.

10. Since the system is intended to facilitate competitive market-making, agency orders could not be executed through the system, but would be handled in the same manner as they are today.

11. Since the execution would take place on the trading floor, transactions would be subject to the NYSE rules. An agreement with non-member market-makers would specify their obligations and the rules with which they must comply. The NASD would not be required to guarantee the transactions of its members who were not members of the NYSE.

12. A quote concentrator would be required as a part of this system, to consolidate the participating market-making quotes. Since the concentrator would be an integral part of the competitive market-maker system, all costs would be borne by the NYSE

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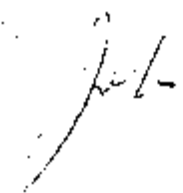
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The above outline summarizes the essential elements of the competitive market-maker system as currently envisioned. Our experience in developing other systems, however, shows that input from others and actual usage during a pilot phase normally result in constructive changes. Thus, we anticipate that discussion with interested member organizations, Exchange Advisory Committees and others may provide valuable additional input that could prompt us to make changes in the proposal before it is finalized.

As we mentioned at our recent meeting, our plans for developing this system, which were not contemplated when we began discussing NASD participation in ITS with you, introduce a significant new consideration in deciding whether to proceed with the earlier proposal for a six-month NASD pilot program in ITS.

After you and your associates have had an opportunity to review these comments, we can discuss any questions you may have about the NASD/ITS open items and the competitive market-maker proposal, and decide what next steps may be appropriate.

Very truly yours,



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