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U.S. House of Representatives
 Committee on Energy and Commerce
 Room 2125, Rayburn House Office Building
 Washington, D.C. 20515

February 23, 1981

CHAIRMAN'S OFFICE

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 SEC. & EXCH. COMM.

FRANK M. POTYER, JR.
 CHIEF COUNSEL AND STAFF DIRECTOR

Honorable Harold M. Williams
 Chairman
 Securities and Exchange Commission
 500 North Capitol Street
 Washington, D.C. 20549

Re: File No. 4-208

Dear Mr. Chairman:

In accordance with the legislative mandate of the Securities and Exchange Commission to "facilitate the establishment of a national market system for securities", I urge the Commission to adopt the proposed order to require the Intermarket Trading System ("ITS") and the National Association of Securities Dealers, Inc. ("NASD") to implement an automated interface between the ITS and NASD's enhanced NASDAQ system. 1 / Further, I urge that the deadline be advanced from September 30, 1981 to May 1, 1981, to the extent meeting such an earlier date would be technologically feasible.

The adoption of the proposed order, albeit much too limited in scope, 2 / is an appropriate step at this time and is necessary to enhance competition in the stock markets. In fact, it is a step that is long overdue. Further delays in response to pressure from special interest groups can only be perceived as an abdication of your responsibilities under the Securities Act Amendments of 1975. ("the 1975 Amendments".)

The order is proposed under authority of the 1975 Amendments enacted, in part, to create a national market system. The goals of that legislation include the economically efficient execution of securities transactions, the assurance of fair competition among a variety of market participants, and the ability of an investor to have an order executed in the best available market. 3 / At the time the legislation was enacted, Congress concluded that "[t]he first order of priority in creating a national market system is to break down the unnecessary regulatory restrictions which now impede contact between brokers and market makers and which restrain competition among markets and market makers." 4 / Congress was convinced that the securities industry must be more competitive. With enhanced competition would come sorely needed improvements in the industry. But, it was also clear that there was deep seated resistance to change within the industry. Accordingly, Congress

designated the SEC to oversee developments to assure that competition did develop and resulting innovations were appropriate to a national market system. The Securities Acts Amendments expanded the Commission's authority to act: by rule or order the Commission "can authorize or require self-regulatory organizations to act jointly with respect to matters as to which they share authority under the Act in planning, developing, operating or regulating a national market system (or a subsystem thereof) or one or more facilities thereof." 5 /

Since enactment of the legislation in 1975, the appropriate Subcommittees of the House Energy and Commerce Committee 6 / have repeatedly expressed concern about the adequacy of progress toward the development of a national market system and the failure of the SEC to fulfill its statutory obligation to eliminate existing anti-competitive restraints. I will not here review the entire history and content of those criticisms. However, with respect to the matter of linkages between markets, which is the subject of the proposed order, it is appropriate to repeat some of those criticisms. The 1975 Amendments provide that "the linking of all markets for qualified securities" is a goal of the national market system. 7 /

- (1) In 1977, the Subcommittees on Oversight and Investigations and Consumer Protection and Finance concluded in a joint report:

It is clear the industry has failed to take any effective initiative, although that is not entirely surprising in light of the divergent interests of the historically separate market centers. The SEC must now exert the necessary leadership to harness those competing interests. It must forcefully move, and move others, to erect physical connections among the separate markets and clearing facilities. 8 /

- (2) In 1980, the Subcommittee on Oversight and Investigations described the widespread agreement it had found that existing electronic systems must be linked. However, it was concerned that despite such widespread agreement, appropriate linkages had not yet been effected.

The Commission's position that the various systems should be linked has widespread support. Witnesses at the Oversight hearings, who agreed on little else, could agree the systems must be linked. That suggestion was sympathetically received by members of the Subcommittees. The industry has repeatedly told the Commission that it supports the linkages. In view of this

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widespread support, it is remarkable that the linkages are still not effected... It should mandate appropriate linkages on terms beneficial to a national market system. There are dangers in further delay: the talks may drag on endlessly with the result that no satisfactory solution is reached... 9 /

The report includes a detailed chronology of discussions among industry participants and the SEC regarding the linkages of the systems. That chronology vividly illustrates that there has been considerable talk, but little progress.

At the time of the issuance of that Subcommittee report, separate views were submitted by key minority Members. They expressed support for the concept of a national market system but felt progress to date had been adequate. Among the reasons given for satisfaction with progress was the expectation that the ITS/NASD linkage would be effected by year end:

Another major difficulty has centered on the fact that although ITS has been in operation for more than two years, the Cincinnati Stock Exchange and the over-the-counter markets have remained outside the system. Protracted negotiations between the present ITS participants and the NASD have given the appearance of foot-dragging. However, there are basic differences between the over-the-counter and exchange auction markets which have largely been responsible for the delays. Now, again with prodding from the SEC, the parties appear to have reached agreement on the terms of participation, and the NASD should join the linkage before year-end. 10 /

The failure of the industry to appropriately effect the ITS and NASD connection, of course, gives rise to this proposed order.

As you recall, in conjunction with the House oversight hearings held in September 1979, the Commission assured the Subcommittee that it would monitor industry progress in fulfilling what it described as "an increased collective commitment to enhance and perfect market linkage and information systems". That commitment included a promise to take regulatory action as necessary. 11 / Now, more than a year later, you propose to follow through on that commitment in a very limited manner.

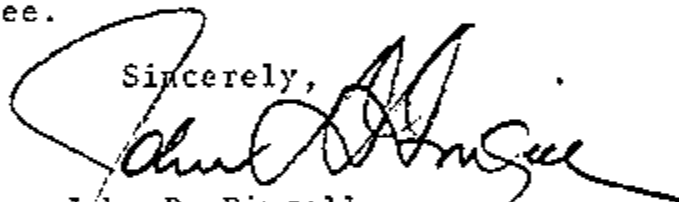
In the proposed order, the Commission is appropriately cognizant of potential problems of internalization. But, the Commission is absolutely correct when it states, "the Commission does not believe that industry efforts to address internalization concerns should operate to delay prompt implementation of the Automated Interface". 12 /

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Fears about the problem of internalization have provided a frequent excuse for not moving forward. For example, some commentators opposed the adoption of Rule 19c-3 because the lack of linkages between the securities markets would provide the potential for internalization. Rule 19c-3 has been adopted, but now some parties seem reluctant to implement the linkages because of the "unresolved" problems of internalization. The Commission should proceed with the linkages and to the extent there are internalization problems, the Commission can utilize its extensive rulemaking authority to resolve those problems.

As detailed in the proposed order, the Commission has repeatedly admonished the industry to act, and has allowed ample opportunity for such action. Therefore, adoption of the order is an important step toward the development of a truly national market and a more competitive industry, and will demonstrate that the SEC is willing to take appropriate action when necessary. Even a modest delay at this point can only be seen as part of a repeated pattern of recalcitrance and foot-dragging, a matter of continuing concern to the Energy and Commerce Committee.

Sincerely,



John D. Dingell
Chairman
Subcommittee on
Oversight and Investigations
and
Committee on
Energy and Commerce

FOOTNOTES

- 1 / Securities Act Release No. 34-17516 (February 5, 1981).
- 2 / As proposed, the order would apply only to stocks covered by the Commission's Rule 19c-3 (adopted in June 1980). That rule covers a limited number of stocks and merely prohibits the expansion of the effect of existing anti-competitive rules from applying to stocks recently listed on stock exchanges. Therefore, most stocks traded in the exchange markets will not be affected by the order. Frankly, there is no logical basis for restriction of the order to the Rule 19c-3 stocks. Further, the optional six month period allowed for experimentation is too generous.
- 3 / H. Rep. No. 129, 94th Cong., 1st Sess., 51 (1975).
- 4 / S. Rep. No. 75, 94th Cong., 1st Sess. 12 and 13. The major regulatory restraints, the off board trading restrictions of the exchanges, although modified, remain in place today. This situation persists despite the legislative mandate to the Securities and Exchange Commission to eliminate rules that act as restraints on competition and cannot be justified by the Securities Exchange Act of 1934. 15 U.S.C. § 78k-1(c) (4) (A) (1975) (emphasis added).
- 5 / 15 U.S.C. § 78k-1(a) (3) (B).
- 6 / Formerly the Interstate and Foreign Commerce Committee.
- 7 / 15 U.S.C. § 78k-1 (a) (2) (1) (D).
- 8 / Subcommittee on Oversight and Investigations and Subcommittee on Consumer Protection and Finance of the House Committee on Interstate and Foreign Commerce, "Oversight of the Functioning and Administration of the Securities Acts Amendments of 1975", 95th Cong., 1st Sess., Comm. Print 27 at 8 (1977).
- 9 / Subcommittee on Oversight and Investigations of the House Committee on Interstate and Foreign Commerce Committee, "National Market System: Five Year Status Report", 96th Cong., 2nd Sess., Comm. Print 56 at 31 & 32 (1980). Events which have occurred subsequent to the issuance of the report are not very significant in the context of the proposed order.
- 10 / Id. at 99.
- 11 / Progress toward the Development of a National Market System, Hearings on the Functioning and Administration of the Securities Acts Amendments of 1975 before the Subcommittee on Oversight and Investigations, and the Subcommittee on Consumer Protection and Finance, 96th Cong., 1st Sess., ser. 96-89 at 518-521 (1979).
- 12 / Supra note 1. at 19.