

AUG 28 1981

Mr. John J. Phelan, Jr.
President & Chief Operating Officer
New York Stock Exchange, Inc.
Eleven Wall Street
New York, New York 10005

Dear John:

Your prompt response to my request that the self-regulatory organizations outline an accelerated program to enhance surveillance of intermarket trading activity is appreciated. Your letter sets forth, for the remainder of this calendar year, a time schedule for completing specific tasks in carrying out the following programs:

- The Intermarket Surveillance Group will continue to work towards improving the timeliness and efficiency for exchanging data among the self-regulatory organizations, and will report to the Commission on these efforts.
- The self-regulatory organizations are committed to having an effective audit trail for equity securities.
- The Intermarket Surveillance Group will identify and document the basic intermarket surveillance procedures which should be in place at each self-regulatory organization, and will ensure proper coordination of intermarket surveillance responsibilities based upon shared data.
- Each self-regulatory organization will furnish for the Commission's review, by year's end, a description of its plan to integrate shared data into its intermarket surveillance capabilities and to enhance its intermarket surveillance capabilities.
- Each self-regulatory organization will make its surveillance information available to the Commission, and will establish clearly defined lines of communication so that the Commission's staff might readily obtain necessary data.

Further, by separate letter, the New York Stock Exchange represented that it will initiate a phased implementation of an effective equities audit trail, covering twenty options stocks by year's end, the remaining options stocks during 1982, and the remaining equity securities during 1983.

Your response evinces a serious commitment to fulfilling intermarket self-regulatory surveillance responsibilities. An effective program of this type -- to which the Commission would have access, as well as an audit capability -- would, in turn, allow the Commission to satisfy its market oversight and enforcement responsibilities, without developing a costly and largely duplicative direct surveillance system.

As you are aware, the Commission has expended considerable efforts towards establishing a Market Oversight and Surveillance System (MOSS) which would allow it to fulfill its mandate to ensure the integrity of the securities markets. Significantly, at this stage of the program's development, the Commission retains the option of establishing either a direct surveillance capability, or a system primarily based on access to, and audit of, an effective self-regulatory surveillance program.

To date, the Commission's pilot MOSS program has presumed that the Commission will need to directly oversee such market activities. As a result of your constructive response, however, the Commission's staff will cooperate fully in the implementation of the objectives of the Intermarket Surveillance Group. Because successful completion of these objectives generally would cause any direct Commission surveillance capability to be duplicative, the Commission will not, at the present time, commit to enhancing substantially its current direct surveillance program. Accordingly, our forthcoming submission to the Office of Management and Budget, regarding our fiscal year 1983 requirements, will not include additional resources to enhance the direct surveillance capability beyond the pilot program.

This pilot program will continue in the interim to operate and be improved, including in some instances by adding stocks and options. Experience with this pilot program will assist the Commission in the development of the requirements for an effective self-regulatory organization surveillance program. This will also provide the Commission with an important informational basis for establishing a meaningful audit process. Moreover, in the event that developing an effective intermarket self-regulatory surveillance system -- through which the Commission could satisfy its public responsibilities of overseeing the securities markets -- proves unfeasible, the pilot program would provide a nucleus for a more direct role in developing the informational predicate needed to ensure the integrity of these markets.

Donald Kittell of the Intermarket Surveillance Group should contact Douglas Scarff, Director of the Commission's Division of Market Regulation, to arrange for the Commission's participation in the Group. We look forward to receiving the scheduled status reports and will actively monitor the Group's progress.

Sincerely,

John S.R. Shad
Chairman