

ONE BANKERS TRUST PLAZA  
NEW YORK, N. Y. 10006

February 5, 1982

Mr. John S. R. Shad  
Chairman  
Securities & Exchange Commission  
500 North Capitol Street, N. W.  
Washington, D. C. 20549

Dear Mr. Shad:

As Chairman of the Specialty Firms Advisory Committee of the New York Stock Exchange, I wish to express, on behalf of the Committee, our strong opposition to the planned ITS/CAES linkage in 19c-3 stocks prior to development of a public order exposure rule. We firmly believe such a rule is necessary to maximize the opportunity for public orders to be executed without the intervention of a dealer.

The SEC has monitored trading in Rule 19c-3 securities and has released a report indicating that the removal of off-board trading restrictions on those securities had no adverse effect on the quality of the primary exchange market. This report also confirmed the SEC's consistently stated belief that trading under Rule 19c-3 cannot be evaluated in a meaningful way until an efficient linkage between OTC and exchange markets has been implemented. Therefore, the SEC ordered that there be an electronic linkage between the Intermarket Trading System (ITS) and the Computer Assisted Execution System (CAES) of the NASD by March 1, 1982.

While the SEC has had concerns about upstairs market makers' internalizing their customer order flow and not exposing those orders to the public, it has determined to proceed with the ITS/CAES linkage without an internalization rule which would ensure the maximum interaction of public investors' orders.

The members of the Specialty Firms Advisory Committee disagree with this position. We believe it is mandatory for a public order disclosure rule to be in place before the ITS/CAES linkage is implemented in order to (1) protect the public, (2) encourage the continuation of open, public markets and (3) provide for a viable, competitive securities industry composed of small, medium and large brokerage firms.

The potential for fragmentation of the market in 19c-3 securities is enormous. In fact, there is evidence that the establishment of private, individual mini-markets could account for as much as half the volume in individual stocks. The prospect of public orders on the floor of the national securities exchanges not being exposed to this potential order flow would place smaller firms, particularly, at a competitive disadvantage.

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The constituency of the Specialty Firms Advisory Committee includes the full spectrum of NYSE member organizations doing public business in the New York Metropolitan area which are not national or regional in scope. These firms constituted almost half of the NYSE membership conducting a public business at the end of 1980. Moreover, of the firms we represent, the majority had less than \$1 million in NYSE commission business in 1980. Thus, one of the great contributions of the public exchanges has been to enable large and small firms alike to compete for order flow in open public markets.

In our opinion, this characteristic of public exchanges has enabled smaller firms to compete with large national firms on the basis of efficiency--and the opportunity to serve the investing public--without restrictions based on size or capital. As a result, our customers have an equal chance to compete fairly and openly with the customers of the most heavily capitalized firms in the securities industry. However, that ability will be destroyed if national firms are allowed to execute the flow of orders coming into their offices against their in-house inventories in those stocks.

We believe that all qualified broker/dealers who are willing to risk capital in market-making should have access to the total market and a fair opportunity to compete for the public's buying and selling interest. By the same token, we believe that no broker/dealer should have a market-making monopoly and that all the orders in any National Market System stock should be exposed to competition from all participating markets. Moreover, only open participation by competing brokers and dealers will assure that public customers can receive the best execution that is available anywhere in the system.

We strongly urge that the ITS/CAES linkage be postponed until a public order exposure rule regarding internalization is in place.

I hope you find our views useful. If we can be of any assistance, please contact us; a list of the members of the Specialty Firms Advisory Committee is attached for your convenience.

Sincerely,



William H. Hazen  
Chairman  
Specialty Firms Advisory Committee

WHH:jcb

Enclosure