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June 22, 1987

Mr. Richard G. Ketchum
Director
Division of Market Regulation
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Re: Request for Postponement of
June 23 Listed-Stock Options Lottery

Dear Rick:

This is in response to your June 18, 1987 letter asking the Exchange to join in a postponement of the allocation of listed-stock options scheduled to occur tomorrow. We would like to explain to you our reasons for initially calling the lottery, and we believe you will understand why we must proceed.

As you well know, the Exchange has long believed that the industry can find a way to permit viable inter-exchange competition within option classes. Despite this belief, we reluctantly agreed in 1985 to become a participant in the Allocation Plan. It was the "price of admission" to trading listed-stock options.

It was a high price to pay. The business consequence has been an inability of either the Exchange or its options floor members to build the critical mass of option products necessary to sustain an economically-viable option business. We and our member firms have been denied the opportunity to take advantage of scale economies.

The Exchange has unused system capacity and excess floor space. Over the last twelve months, we have invested nearly $1.0 million in reconfiguring our options floor, in adding fixtures and hardware, and in enhancing our options systems' capacity. Our options floor can accommodate many times its present population; our options systems, many times our present volume.

Our options specialist units have committed manpower, technology and capital to making markets in options on the NYSE. But they are businessmen, not philanthropists. They will not long carry the fixed costs of traders, clerks, systems and capital without an opportunity to spread them over more products. Yet, today, five of our nine option specialist units have only <u>one</u> options product to trade.

Our 72 competitive options traders face similar frustrations. We have already witnessed the migration to the floors of our competitors of many traders who learned the business here. Turnover in our traders can only increase, their ranks only thin, if we must further defer our provision to them of new business opportunities.

The final tally is this: after almost three years, the Exchange can trade options on only 13 listed stocks. Although tomorrow's lottery will add only ten more, it almost doubles our listed-stock options products.

In contrast, our smallest competitor, the Pacific Stock Exchange, trades options on 72 listed stocks. Our largest competitor, the Chicago Board Options Exchange, trades options on more than twice that number. Moreover, because the Allocation Plan had been in effect for five years before we entered the market, our competitors had already divided up the best options stocks among themselves. This left for us options on mostly less attractive stocks -- and even then, to choose only every fifth one. Thus, while we trade options on only three percent of the 432 listed-stocks currently subject to options trading, our share of trading is even less -- 0.9 percent:

And the rich get richer. Thanks to the Allocation Plan's replacement provisions, our competitors enjoy a proportionately greater opportunity to select the best new stocks as they become options eligible before we can even get a chance at them through a lottery.

Our competitors are considering your request from an entrenched competitive position. With five to 11 times the number of option stocks, they can fully afford to defer any further expansion of their product lines. Tomorrow's lottery can only add what are to them very marginal option stocks when compared to IBM, Digital, Salomon Brothers and General Mills. They have no material business reason to participate tomorrow, and they should accede to your request.

Our lottery request seeks ten option stocks. Only our competitors' participation brings the total to 50. Tomorrow's lottery is vital to us, marginal to them. Given their advantageous competitive position and, at least in the case of the American Stock Exchange, its public opposition to participation in tomorrow's lottery, their course is clear: they should pass.

We would, too, were your request that we defer adding new classes for a week or even for a month. But no such short-term deferral is assured.

Although the Commission's action last Thursday brings the possibility of multiple trading a major step forward, it remains no more than that -- a possibility. Several of the other options exchanges continue to voice vigorous opposition to multiple trading, as do several member firms and the SIA Derivative Products Committee. This means that the likely duration of a proceeding that might lead to multiple trading is guaranteed to be many months. If the Commission does, in fact, approve the nullifying rule, that approval will not occur earlier than October (an optimistic estimate). Litigation could delay that nullification, if it occurs at all, until far into the future.

* * *

We hope this letter helps you to appreciate our business situation and how it differs from that of our competitors. We hope you can understand why, although we appreciate the reasons behind your request, we have reluctantly concluded that we have no alternative but to increase our and our member firm's options products through participation in tomorrow's lottery.

Sincerely yours,

Robert J. Birnbaum

cc: Messrs. Alger B. Chapman
Nicholas A. Giordano
Arthur Levitt, Jr.
Dr. Maurice Mann