

HAND DELIVERED  
BY KATY . 6-1



UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

April 19, 1988

CHAIRMAN'S OFFICE  
MAILED

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Signed by: \_\_\_\_\_

The Honorable Edward J. Markey  
Chairman  
Subcommittee on Telecommunications  
and Finance  
House of Representatives  
Washington, DC 20515

Re: Contingency Planning

Dear Chairman Markey:

This letter responds to your letter of April 12, 1988 concerning the progress to date of the Commission, the Commodity Futures Trading Commission ("CFTC"), and the Federal Reserve Board ("FRB") in developing contingency plans in a variety of areas to address periods of extreme market volatility. While your letter indicates your disappointment regarding the pace of these developments, I must reemphasize that substantial progress has been achieved in a number of areas, and that my letter of March 31, 1988 accurately details this progress by the Commission, the CFTC, and the FRB, as well as the securities and futures self-regulatory organizations ("SROs"), since the market break. Please be assured that all of us are acting responsibly and cooperatively to guard against a repetition of the events of October 19 and 20, 1987.

As I previously have indicated, our efforts have focused primarily on three broad subject areas: (1) development and coordination of circuit breaker mechanisms; (2) monitoring and information sharing of the financial condition of market participants; and (3) similar monitoring and information sharing procedures for market conditions.

My testimony on March 23, 1988 before the subcommittee contained recommendations concerning circuit breaker mechanisms in general and trading halts in particular. Brief trading halts in stocks will be useful in permitting market participants to evaluate and react to market conditions. Halt based upon predetermined price thresholds can be automatically implemented by the markets when these thresholds are reached. Confirmatory announcements can then

be disseminated to the public through newswire services. It is also important that trading halts be coordinated across markets. Coordinated trading halts are a crucial area of ongoing discussions among the SROs and the members of the Working Group on Financial Markets.

In the area of monitoring of the financial condition of market participants, the Commission's current procedures have functioned well during periods of extreme market volatility. As I indicated in my March 23rd testimony and March 31st letter, during the October market break our staff performed "sweeps" of broker-dealers nationwide to detect and address any potential problems in their financial integrity. While the Commission staff will again use its expertise to perform this function in future periods of market stress, it is not practical to predetermine firm-specific remedial measures which might be appropriate under all circumstances.

The monitoring procedures used by the Commission to keep abreast of trading an operational conditions during periods of extreme volatility are discussed in detail in Chapter Two of the Commission staff report on the October 1987 market break and are summarized in my March 31st letter. I believe that the sharing of this financial and market information among the Commission, the CFTC, the FRB, the SRO's and other organizations operated well during the market break. Our current efforts seek to enhance information sharing arrangements, but we believe flexibility rather than formality should be the guiding principle.

Your letter of April 12th also raised a number of specific issues relative to inter-agency coordination and contingency planning during a market break. The following will outline the Commission's position on each of these issues.

Coordination and Communication of SEC and CFTC Decision-Making and Resolution of Disagreements

While we cannot assure you that the Commission and the CFTC currently agree on all issues which may confront us during a market break, we are continuing through the Working Group on Financial Markets and direct discussions with the CFTC to attempt to reach understanding on various market related issues such as inter-market circuit breakers. My March 31st testimony reiterated the Commission's recommendations that the SEC, which has the mandate of

preserving the integrity of the nation's securities markets, should have regulatory authority over all equity derivative markets. Absent this authority, the Commission should have a "tie-breaking" capacity to resolve intermarket issues that affect the securities markets. In any event, the Commission will maintain its present excellent lines of communications with the CFTC. In periods of market volatility the CFTC and the Commission will be in constant communication with each other and with the SRO's and member firms. Information on each agency's determinations will be conveyed to the SRO's by telephone. Public announcements will be carried over news services in order to inform the markets.

#### Authority of SROs to React to Crises

While the Commission requires the securities SROs to consult with us on significant regulatory measures, the self-regulatory scheme clearly permits the markets to react swiftly to changing conditions to minimize harm to markets and investors. The experience of the October market break shows that these two interests, adequate consultation and prompt remedial actions, are not incompatible.

#### Relaxation or Interpretation of Rules

The Commission did not relax any securities laws or regulations during the October market break. Rather, our staff simply reminded interested parties that trading outside of certain "safe harbor" regulations regarding issuer stock repurchases were not per se violations of antifraud rules. Such clarifications have been and will be issued on an as-needed basis.

#### FRB Liquidity Support

The Commission has never suggested that the FRB should act as "lender of last resort" to ensure market maker liquidity. The Working Group, however, is reviewing means of ensuring that adequate credit is available through private arrangements between market makers and their banks. In addition, we are reviewing steps which might provide for better linkages between the clearance and payment systems for stocks and derivative securities.

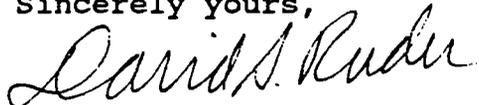
Circuit Breaker Mechanisms

The Commission's efforts in this area are discussed above.

Finally, I should note that the Commission staff currently is formalizing specific procedures and interagency and SRO contacts for use in periods of extreme market volatility. These procedures are implemented whenever market conditions warrant more direct scrutiny of the SROs by our staff. Because these procedures involve simply increasing the level of monitoring and consulting efforts that already are part of our staff's routine functions, we do not believe that a specific price or volume "threshold" should be set for the implementation of these procedures.

If it would be beneficial to the Subcommittee's understanding of these contingency plans, the Commission staff will be available to provide the Subcommittee staff with a confidential briefing on our efforts to improve the strength, resiliency and preparedness of the securities markets.

Sincerely yours,



David S. Ruder  
Chairman