

August 23, 1967

Mr. G. Keith Funston, President
New York Stock Exchange
Eleven Wall Street
New York, New York 10005

Dear Mr. Funston:

This refers to your letter of July 7, 1967, concerning Rule 394. In your letter you state that one of the reasons why firms do not use Rule 394 is because the member brokers "receive satisfactory executions and prices on the floor of the exchange". You also note that the member firms may not be checking the third market because "making inquiries of the several non-member market-makers registered in a given stock would be time consuming, particularly since speed in executing orders is usually essential". We have been advised by representative of the third market, consistent with this point, that one of the reasons for the failure to use Rule 394 is the Exchange's interpretation of 394 to the effect that a member firm must attempt to execute the order on the floor of the exchange before it obtains quotes from a non-member market maker. Apparently, it is not feasible for a member firm to forgo immediate executions on the floor while checking markets off the floor because during the interim floor prices are constantly changing. We must emphasize that Rule 394 was designed to make it possible for a member to execute off the floor if he could get a better price. The interpretation you have given this rule may make it impossible as a practical matter for him to do so.

It has also been suggested that member firms are reluctant to go to the third market after having revealed their order on the floor of the exchange as they have no way of knowing whether there is a reasonable possibility of obtaining an off-board execution at a better price. In this connection, the interpretation referred to above may cause the Rule to operate to the disadvantage of regional based firms who must transmit their orders to correspondents without awareness of the prices in the third market. The correspondent has neither the incentive nor the time to leave the floor and check the third market. If it were possible for the member firms first to obtain from a non-member market maker a bid and asked quotation (without attempting to make or making a contract of purchase or sale), the member firm might then be in a position to make a more informed decision while on the floor as to whether it would be worthwhile to attempt an off-board execution.

Inasmuch as your letter indicated that the exchange market can and does effectively compete with the third market, an obvious question arises: Could not

the purpose of Rule 394(b) be furthered by removing one of the practical difficulties to the timely obtaining of the third market information?

An interpretation which would make it clear that the Rule does not operate to forbid a member firm from making a preliminary informational inquiry of a market maker prior to attempting to execute an order on the floor of the exchange would appear to be consistent with the points made in your letter and would assist member firms in obtaining adequate information with which to exercise their best business judgment on behalf of their customers. This interpretation would, of course, be subject to the limitations alluded to in the preceding paragraph.

The Commission would appreciate your views and looks forward to discussing this important matter with you.

Sincerely,
Manuel F. Cohen
Chairman