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The Honorable Christopher Cox
Chairman
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Dear Chairman Cox:

I am writing you today in light of yesterday's 777 point drop in the Dow Jones Industrial Average following the failure of the House of Representatives to adopt the administration's proposed financial rescue plan. It appears that the stock market may be headed into a period of heightened volatility in reaction to the current uncertainty regarding the future of the rescue plan, and I am concerned about the prospect for such volatility to be further exacerbated by internal market mechanisms.

In the aftermath of the October 1987 Crash, the October 1989 "mini Crash," and the failure of Drexel Burnham following the collapse of the junk bond market, Congress had similar concerns regarding the stability of our nation's securities markets. In order to address these concerns, I spearheaded H.R. 3657, the Market Reform Act of 1990, a bill which President George H.W. Bush signed into law on October 16, 1990 (see Public Law 101-432).

One of the key provisions I authored in this bill, Section 6, was designed to address the excesses resulting from computerized program trading. Section 6 gave the Securities and Exchange Commission the authority to "prohibit or constrain, during periods of extraordinary market volatility, any trading practice in connection with the purchase or sale of equity securities that the Commission determines (A) has previously contributed significantly to extraordinary levels of volatility that have threatened the maintenance of fair and orderly markets; and (B) is reasonably certain to engender such levels of volatility if not prohibited or constrained." The

provision also gave the Commission the power to “prescribe means reasonably designed to prevent manipulation of price levels of the equity securities market or a substantial segment thereof.”

In adopting this provision, the Congress determined that there was a need to ensure that the Commission could take action in this area in light of the demonstrated connection between program trading and the type of excessive market volatility that resulted in the 1987 stock market crash and the 1989 “mini-crash.” In my floor statement explaining the intent of this provision, I noted that:

“...the need for this provision stems from the changes which have significantly reshaped our securities markets in the last decade – the swift domination of the stock market by institutions, and the rise of trading by securities firms for their own accounts.

“The concentration of greater and greater financial power in the hands of fewer individuals has led to the birth of a host of new trading strategies and financial instruments which have been specifically tailored for trading the value of the stock market as a whole. The umbrella term for such strategies is program trading, which covers index arbitrage, portfolio insurance, tactical asset allocation, and other strategies. Unfortunately, with the increased dominance of the market by institutions and securities firms, has come the opportunity to profit from manipulative acts or practices such as intermarket frontrunning or self-frontrunning, or aggressive trading strategies which prey on the existing fragility of our markets....The power we give the Commission today assures that our regulators will be able to deal with such developments, should they arise in the future.” (See Congressional Record, September 28, 1990, at H8381)

Now is one of those times when the Commission needs to make every effort to help stabilize the markets.

In this regard, I note that the New York Stock Exchange (NYSE) last year repealed the index arbitrage restrictions contained in Rule 80A (see Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to Rule 80A (Index) SECURITIES AND EXCHANGE COMMISSION (Release No. 34-56726; File No. SR-NYSE-2007-96) October 31, 2007 Self-Regulatory Organizations; New York Stock Exchange LLC; Notice of

Filing and Immediate Effectiveness; Size: 15403 Modified: 11/01/2007 </rules/sro/nyse/2007/34-56726.pdf>.) These restrictions had required that whenever the NYSE Composite Index advanced or declined by a predetermined value from the previous day closing value (set at two percent at the time the Rule was eliminated), that all index arbitrage orders to buy or sell had to be entered as either "buy minus" or "sell plus".

In repealing this rule, a rule which the Exchange noted had been adopted "as one of the responses to the market break of October 1987 to reduce market volatility and promote investor confidence," the NYSE argued that "it does not appear that the approach to market volatility envisioned by the use of these 'collars' is as meaningful today as when the rule was formalized in the late 1980s." The NYSE further argued that "volatility is neither restrained or enhanced by the imposition of the collars" and that it is "likely that markets will reverse trends whether or not Rule 80A is invoked." Finally, the NYSE argued that the rule "addresses only one type of trading strategy, namely index arbitrage, whereas the number and type of strategies have increased markedly in the last 20 years and may well contribute to the increase in or lack of volatility."

In light of the current fragility of our nation's financial markets, I request that the Commission consider immediately ordering the NYSE to reinstate its Rule 80A. In addition, if there are other types of trading strategies being used that may result in increased volatility in our equities markets, I would suggest that rather than eliminate the rule restricting one of them, the SEC would have been better advised to order the NYSE to adopt or update its rules to address all such strategies. The program trading authority that Congress gave the Commission 18 years ago granted it the power to address such situations.

In addition, I request that the Commission provide responses to the following questions:

1. On what basis did the Commission approve adoption of the NYSE rule repealing NYSE Rule 80A?
2. Did the SEC staff conduct any independent investigation or analysis of the effectiveness of the Rule? If so, please provide me with copies of any reports or memoranda containing such analysis or investigations. If not, please explain why no such independent investigations or analyses were performed.

3. Does the SEC agree that Rule 80A's approach to market volatility was no longer meaningful? If so, what is the basis for such a conclusion? If not, why did the SEC allow the NYSE to repeal the rule?
4. If Rule 80A was no longer as effective as it was upon adoption, why did the SEC not consider requiring the NYSE to update the rule to response to changing trading strategies or market conditions so that it would be more effectively, rather than approving the repeal of the rule?
5. The NYSE argued that "the NYSE argued that the rule "addresses only one type of trading strategy, namely index arbitrage, whereas the number and type of strategies have increased markedly in the last 20 years and may well contribute to the increase in or lack of volatility." What are the other trading strategies being pursued in today's markets, in addition to index arbitrage, which may contribute to an increase in market volatility?
6. Has the SEC examined whether such trading strategies or practices may afford aggressive trading firms with an opportunity to profit from manipulative acts or practices such as intermarket frontrunning or self-frontrunning, or use aggressive trading strategies which prey on the existing fragility of our markets? If not, why not? If so, what action has the Commission taken to prohibit or constrain such strategies or practices?
7. Instead of repealing Rule 80A because there might be trading practices or strategies other than index arbitrage that might lead to increased market volatility, why did the SEC not require the NYSE to expand or modify the rule to address such strategies or practices?

Thank you for your assistance and cooperation in providing a response to these questions. Should you have any questions about this inquiry, please have your staff contact Mr. Jeff Duncan of my staff at 202-225-2836.

Sincerely,


Edward J. Markey
Member of Congress