MEMO# 24334

May 27, 2010

SEC Publishes Stock-by-Stock Circuit Breaker Rule Proposals

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TO: CLOSED-END INVESTMENT COMPANY MEMBERS No. 27-10
ETF (EXCHANGE-TRADED FUNDS) COMMITTEE No. 12-10
ETF ADVISORY COMMITTEE No. 20-10
EQUITY MARKETS ADVISORY COMMITTEE No. 18-10
SEC RULES MEMBERS No. 50-10 RE: SEC PUBLISHES STOCK-BY-STOCK CIRCUIT BREAKER RULE PROPOSALS

Following the market events of May 6, 2010, the national securities exchanges have filed proposals with the Securities and Exchange Commission that would establish uniform market-wide trading halt, or "circuit breaker," standards to permit the exchanges to pause trading for individual securities in the S&P 500 Index [1] in the event of extraordinary market conditions or at the direction of the SEC. [2] The circuit breaker proposals would become effective on June 7 and continue as pilot programs through December 10, 2010, after which the market experience would be evaluated and consideration would be given to whether they should be extended or modified.

Exchange Proposals

The exchange proposals would provide that a listing market could halt trading in a security if the price of the security moves ten percent or more, in either direction, as compared to prices of that security in the preceding five-minute period during a trading day. The ten percent move in price would be calculated every second by comparing each last consolidated sale price of a security during the preceding second to a reference price. The reference price would be any transaction in that security printed to the Consolidated Tape during the five-minute period before the calculation time.

The proposals would be in effect from 9:45 a.m. to 3:35 p.m. Eastern Time to enable the market to absorb the opening price of a security and to participate in the close. Accordingly, in the first five minutes of the calculation period, prices for comparison would not be based on five minutes of trading in that security. For example, a trade at 9:45:05 would be compared only to trades between 9:45:00 and 9:45:05. The last potential trade to trigger a circuit breaker would be at 3:35 p.m., so that such trading pause will end at 3:40 p.m.

As proposed, only regular way, in-sequence transactions would qualify for use in calculations of price moves. To ensure that erroneous executions would not trigger a circuit breaker, the proposals would permit an exchange to exclude a transaction price from use in calculating price movements if it concludes that the transaction price resulted from an erroneous execution. The proposals further would provide that if a circuit breaker is triggered, the exchange will immediately notify the single plan processor responsible for consolidation of information for the security.

According to the proposals, the listing market would have five minutes to re-open trading in a halted security, and it would do so pursuant to the re-opening procedures set forth in its trading rules. [3] The re-opening of a security following a trading halt would be at the end of the five-minute trading pause, and could be either on a trade or a quote. In the event of a significant imbalance, an exchange would be permitted to delay the re-opening of the security an additional five minutes. The exchange, however, would be required to notify other markets if it could not re-open because of issues unrelated to an order imbalance, thereby enabling other markets to resume trading even if the primary market has not re-opened. The proposals would provide that if a listing market re-opens the security after other markets have resumed trading, such re-opening would be subject to Rule 611(b)(3) of Regulation NMS as an exception to the Order Protection Rule.

The proposals would provide that if the listing market for a security that trades on an exchange on an unlisted trading privilege ("UTP") basis pauses under its respective rules, the exchange also would pause trading in that security until the listing market has either resumed trading or the exchange has received notice from the primary listing market that trading may resume. Moreover, if the primary listing market does not reopen trading in the security within ten minutes of notification of a trading pause, the proposals would permit the exchange to resume trading of the security.

FINRA Proposal

Consistent with the exchanges' proposals, the Financial Industry Regulatory Authority has filed with the SEC a proposal to amend its rules to incorporate the proposed single-stock circuit breakers. [4] Specifically, FINRA would add new supplementary material to its rules providing that, if a primary listing market has issued an individual stock trading halt under its rules, FINRA would cease trading in that security by FINRA members otherwise than on an exchange [5] until trading has resumed on the primary listing market. The supplementary material would further provide that, if trading has not resumed on the primary listing market and ten minutes have passed since the individual stock trading pause message has been received from the responsible single plan processor or the primary listing market has issued notice that it cannot resume trading for a reason other than a significant imbalance, FINRA would permit the resumption of trading if trading has commenced on at least one other national securities exchange.

Heather L. Traeger
Associate Counsel

endnotes

[1] At this time, the circuit breakers only would apply to securities in the S&P 500 Index. The exchanges, however, would continue to assess whether additional securities should be added to the pilot programs and whether the parameters of the proposed circuit breaker rules would need to be modified to accommodate trading characteristics of different securities (e.g., exchange-traded funds).

[2] See SEC Press Release 2010-80, SEC to Publish for Comment Stock-by-Stock Circuit Breaker Rule Proposals, May 18, 2010. See also SEC Release No. 62121 (May 19, 2010), File No. SR-BATS-2010-014, available at http://www.sec.gov/rules/sro/bats/2010/34-62121.pdf; SEC Release No. 62130 (May 19, 2010), File No. SR-CHX-2010-10, available at http://www.sec.gov/rules/sro/chx/2010/34-62130.pdf; SEC Release No. 62122 (May 19, 2010), File No. SR-EDGA-2010-01, available at http://www.sec.gov/rules/sro/edga/2010/34-62122.pdf; SEC Release No. 62123 (May 19, 2010), File No. SR-EDGX-2010-01, available at http://www.sec.gov/rules/sro/edgx/2010/34-62123.pdf; SEC Release No. 62125 (May 19, 2010), File No. SR-ISE-2010-48, available at http://www.sec.gov/rules/sro/ise/2010/34-62125.pdf; SEC Release No.

62124 (May 19, 2010), File No. SR-BX-2010-037, available at http://www.sec.gov/rules/sro/bx/2010/34-62124.pdf; SEC Release No. 62129 (May 19, 2010), File No. SR-NASDAQ-2010-061, available at http://www.sec.gov/rules/sro/nasdaq/2010/34-62129.pdf; SEC Release No. 62131 (May 19, 2010), File No. SR-NSX-2010-05, available at http://www.sec.gov/rules/sro/nsx/2010/34-62131.pdf; SEC Release No. 62126 (May 19, 2010)

File No. SR-NYSE-2010-39, available at http://www.sec.gov/rules/sro/nyse/2010/34-62126.pdf; SEC Release No. 62127 (May 19, 2010), File No. SR-NYSEAmex-2010-46, available at http://www.sec.gov/rules/sro/nyseamex/2010/34-62127.pdf; SEC Release No.

62128 (May 19, 2010), File No. SR-NYSEArca-2010-41, available at http://www.sec.gov/rules/sro/nysearca/2010/34-62128.pdf.

[3] The NYSE and NYSE Amex have proposed several revisions to their existing re-opening procedures. First, an indication would need to be published as close to the beginning of the

trading halt as possible and such indications would need to be updated until the security has re-opened. Even so, the security could re-open even if the designated market maker does not have an opportunity to update an indication to reflect changes to order flow before the re-opening time. Second, any re-openings following a trading halt would not be subject to the requirements that (i) a minimum of three minutes must elapse between the first indication and a security's re-opening, or (ii) if more than one indication is published, a minimum of one minute must elapse before a security's re-opening. Third, the exchange would publish Order Imbalance Information, as defined in Rule 15(c) under the Securities Exchange Act, approximately every fifteen seconds following the imposition of the trading halt until the security re-opens.

[4] See SEC Release No. 62133 (May 19, 2010), File No. SR-FINRA-2010-025, available at http://www.sec.gov/rules/sro/finra/2010/34-62133.pdf.

[5] In other words, the FINRA proposal would apply to transactions on all alternative trading systems, including dark pools and electronic communication networks, and any other execution in the over-the-counter market.