

**MEMO# 31771**

May 23, 2019

## **SEC Issues Order Approving Amendment to Limit Up-Limit Down Plan**

[31771]

May 23, 2019 TO: ICI Members

ICI Global Members

Equity Markets Advisory Committee

ETF (Exchange-Traded Funds) Committee SUBJECTS: Trading and Markets RE: SEC Issues Order Approving Amendment to Limit Up-Limit Down Plan

The Securities and Exchange Commission (SEC) recently approved the Eighteenth Amendment to the National Market System (NMS) Plan to Address Extraordinary Market Volatility (the “Limit Up-Limit Down Plan”).[\[1\]](#) The Amendment (1) transitions the Limit Up-Limit Down Plan from operating on a pilot to a permanent basis; (2) establishes a mechanism for periodic review and assessment of the plan; and (3) recalibrates the formula used to determine the thresholds for trading pauses around the market open and, for some NMS stocks, the close.

During the comment period, ICI, jointly with the Investors Exchange (IEX) and SIFMA, submitted a comment letter urging the SEC to revise the outdated governance provisions of the plan, which confer all decision-making power in an operating committee composed exclusively of the self-regulatory organizations (SROs)—*i.e.*, the exchanges and FINRA. Our letter recommended that the Commission add representatives of non-SROs, including advisers to registered funds and broker-dealers, to the operating committee of the Limit Up-Limit Down Plan and other NMS plans. The letter argued that diversifying NMS plan operating committees would make these committees better informed and less influenced by conflicts of interest.[\[2\]](#)

### **Background on the Limit Up-Limit Down Plan**

The Limit Up-Limit Down Plan, which went into effect in April 2013 (in pilot form), provides a market-wide mechanism to address significant fluctuations in the price of individual securities over a short period of time, such as those experienced during the “Flash Crash” on the afternoon of May 6, 2010. The plan seeks to prevent trades from occurring outside of specified price bands and employs trading pauses to accommodate more fundamental price moves.

The plan requires the calculation and dissemination of a lower and upper price band for each NMS stock. All trading centers for NMS stocks must establish, maintain, and enforce

written policies and procedures designed to prevent trades at prices that are below the lower price band or above the upper price band. The price bands for an NMS stock are calculated by applying a specified “Percentage Parameter” to the stock’s reference price.<sup>[3]</sup> Between 9:30 a.m. to 9:45 a.m. and 3:35 p.m. to 4:00 p.m. (or, in the case of an early scheduled close, the last 25 minutes of trading), the Percentage Parameters for each NMS stock are doubled.

An NMS stock enters a limit state when the national best offer for the stock equals the lower price band and does not cross the national best bid, or the national best bid equals the upper price band and does not cross the national best offer. If the stock remains in a limit state for 15 seconds, the primary listing exchange must declare a trading pause, which lasts for at least five minutes. The plan includes procedures intended to facilitate a smooth reopening of trading in a stock following a trading pause.

## **Summary of Amendment**

The Limit Up-Limit Down Plan has operated on a pilot basis since its inception in 2013. The Amendment transitions the plan from operating on a pilot to a permanent basis because, as noted by the Commission, the plan “has operated effectively in accomplishing its stated goal of addressing extraordinary market volatility.”<sup>[4]</sup>

The SEC recognizes, however, that the equity market is “dynamic and constantly evolving”, and therefore the Amendment includes a mechanism for ongoing periodic review and assessment of the plan. This mechanism is intended to guarantee that the plan will be monitored in a data-driven manner. Under the Amendment, the plan’s operating committee (*i.e.*, the SROs), in consultation with the advisory committee (a group composed of non-SRO industry participants), will provide to the Commission and make publicly available an annual report, certain quarterly data, and reports on market events. The annual report will include updates on the plan’s operations, including an examination of the Percentage Parameters for price bands set forth in the plan, analysis of any amendments to the plan that may have occurred, and an analysis of any material issues that have been identified and may directly impact the operation of the plan.<sup>[5]</sup> Required quarterly data will include basic statistics that can be used to identify trends in the performance of the limit up-limit down mechanism and to measure its effect on market activity.

In addition to the information provided annually and quarterly, the Commission may request that the SROs provide, and make publicly available, a report analyzing the plan’s operation during a significant market event. The Amendment also empowers the Commission to request additional, nonpublic information from Participants. <sup>[6]</sup>

The Amendment also recalibrates the formula used to determine the thresholds for trading pauses around the market open and close. The plan provides that the price bands for an NMS stock are calculated by applying a Percentage Parameter to the stock’s reference price, and this Percentage Parameter is doubled between 9:30 a.m. and 9:45 a.m. and during the last 25 minutes of scheduled trading. The Amendment eliminates the doubling of the applicable Percentage Parameters between 9:30 a.m. and 9:45 a.m. for all stocks. It also would cease the doubling of Percentage Parameters of certain NMS stocks with a reference price above \$3.00 during the last 25 minutes of scheduled trading.<sup>[7]</sup>

The Commission recognizes that the process of calibrating the price bands must accomplish dual objectives: preventing extraordinary volatility and facilitating price discovery.<sup>[8]</sup> If price bands are too wide, there is potential for dramatic price swings—as much as 40% when trading from the upper price band to the lower price band under the pilot version of

the Limit Up-Limit Down Plan.<sup>[9]</sup> Conversely, eliminating the double-wide price bands may lead to increased trading pauses that could impede price discovery and harm investors.<sup>[10]</sup> In the order adopting the Amendment, the Commission determined that the benefits of preventing extraordinary volatility outweigh potential harms to price discovery, in part because market participants might adjust their quoting behavior to mitigate the potential for the Amendments to reduce price discovery.

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#### endnotes

<sup>[1]</sup> See Joint Industry Plan, Order Approving the Eighteenth Amendment to the National Market System Plan to Address Extraordinary Market Volatility, 84 Fed. Reg. 16086 (April 11, 2019), *available at* <https://www.govinfo.gov/content/pkg/FR-2019-04-17/pdf/2019-07637.pdf> (the “Amendment”).

<sup>[2]</sup> See Letter from T.R. Lazo, Managing Director and Associate General Counsel, SIFMA, Susan M. Olson, General Counsel, ICI, and John Ramsay, Chief Market Policy Officer, IEX, dated January 16, 2019, *available at* <https://www.ici.org/pdf/31564a.pdf>.

<sup>[3]</sup> A reference price is the mean price of transactions completed over the immediately preceding five-minute period that are eligible to update the last sale price of an NMS stock.

<sup>[4]</sup> See Amendment at 16089.

<sup>[5]</sup> See Amendment at 16090.

<sup>[6]</sup> See Amendment at 16090.

<sup>[7]</sup> The Limit Up-Limit Down Plan divides NMS stocks into two tiers. Tier 1 stocks include those in the S&P 500 and Russell 1000 indexes as well as the exchange-traded products specified in schedule 1 to Appendix A of the plan. All other NMS stocks are Tier 2 except for rights and warrants, which are excluded from the plan. The proposed change would apply to Tier 2 stocks with reference prices above \$3.00.

<sup>[8]</sup> See Amendment at 16091.

<sup>[9]</sup> See Amendment at 16092.

<sup>[10]</sup> See Amendment at 16091.