MEMO# 25079

April 11, 2011

SEC Publishes Limit Up-Limit Down Proposal

[25079]

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TO: CLOSED-END INVESTMENT COMPANY COMMITTEE No. 21-11
ETF (EXCHANGE-TRADED FUNDS) COMMITTEE No. 9-11
ETF ADVISORY COMMITTEE No. 23-11
EQUITY MARKETS ADVISORY COMMITTEE No. 19-11
SEC RULES COMMITTEE No. 31-11 RE: SEC PUBLISHES LIMIT UP-LIMIT DOWN PROPOSAL

The Financial Industry Regulatory Authority (FINRA) and national securities exchanges have filed a proposal with the Securities and Exchange Commission to establish a new "limit up-limit down" mechanism to address extraordinary market volatility in the U.S. equity markets. [1] The proposed limit up-limit down mechanism would be implemented as a one-year pilot program and would replace the existing single stock circuit breakers, which were approved shortly after the market events of May 6, 2010. [2] Comments on the proposal, which is summarized below, must be filed with the SEC 21 days after the proposal is published in the Federal Register.

We will hold a conference call on Thursday, April 21, at 2:00 p.m. Eastern time to discuss the proposal and possible ICI comments. If you plan to participate on the call, please contact Jennifer Odom by email at jodom@ici.org or by phone at 202-326-5833 to receive the dial-in information.

Proposal

The existing circuit breaker pilot pauses trading in a stock across the equity markets for a five-minute period if the stock experiences a 10 percent change in price over the preceding five minutes. In contrast, the proposed limit up-limit down mechanism would prevent trades in listed equity stocks from occurring outside of a specified price band, which would be set at a percentage level above and below the average price of the security over the immediately preceding five-minute period.

- For stocks currently subject to the circuit breaker pilot, the percentage would be 5 percent (Tier 1). [3]

- For stocks not subject to the pilot, the percentage would be 10 percent (Tier 2).

The percentage bands would be doubled during the opening and closing periods, and stocks priced below $1.00 would use the lesser of $.15 or 75 percent. [4] If trading is unable to occur within the price band for more than 15 seconds, there would be a five-minute trading pause. No trades would occur during a pause, but all bids and offers could be displayed.

The process of reopening trading after a pause would depend on the time at which the pause was triggered. During regular trading hours, the primary listing exchange would attempt to reopen trading five minutes after the declaration of a pause using its established reopening procedures. If it is unable to do so for any reason other than a significant order imbalance, all trading could resume upon public notification of the primary exchange's inability to open the stock. In addition, if trading does not reopen within ten minutes, and the primary listing exchange has not declared a regulatory halt, all trading centers would be permitted to begin trading the stock. For pauses within five minutes of the end of regular trading hours, the primary listing exchange would attempt to execute a closing transaction, using its established closing procedures. All trading centers would be able to trade the stock after execution of the closing transaction. If the primary listing exchange was unable to execute a closing transaction within five minutes after the end of regular trading hours, all trading centers could begin trading the stock.

The proposal would apply to all trading centers, including exchanges, ATSs, and broker-dealers executing internally. These trading centers would have to establish policies and procedures reasonably designed to prevent trades from occurring outside the applicable price bands, to honor any trading pause, and to otherwise comply with the procedures set forth in the plan.

The proposal would be implemented in two phases. During Phase I, only Tier 1 stocks would be subject to the limit up-limit down mechanism. In addition, the first price bands would be calculated and disseminated 15 minutes after the start of regular trading hours, and would cease to be calculated and disseminated 30 minutes before the end of regular trading. Six months after the initiation of Phase I, or such earlier date as may be announced, Phase II would begin. Phase II would include full implementation of the proposal to all listed equity stocks beginning at 9:30 a.m. Eastern Time and ending at 4:00 p.m. Eastern Time each trading day.

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endnotes

[1] See "SEC Announces Filing of Limit Up-Limit Down Proposal to Address Extraordinary Market Volatility," SEC Press Release 2011-84, April 5, 2011; available at http://www.sec.gov/news/press/2011/2011-84.htm.

[2] The circuit breaker pilot was initially approved by the SEC on June 16, 2010, and is currently set to expire on August 11, 2011, or earlier if a limit up-limit down mechanism is implemented before then. See SEC Release 34-64192, Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Extend the Effective Date of the Trading Pause Pilot, dated April 5, 2011; available at

http://www.sec.gov/rules/sro/finra/2011/34-64192.pdf. The SEC also is continuing to work with the Commodity Futures Trading Commission and the markets to consider recalibrating market-wide circuit breakers that apply across the securities and futures markets.

[3] The circuit breakers apply to securities in the S&P 500 Index and Russell 1000 Index as well as certain exchange-traded funds.

[4] The percentage band for a Tier 2 stock that is a leveraged exchange-traded fund would be the same as other Tier 2 stocks multiplied by the leverage ratio of such product.