INVESTMENT COMPANY INSTITUTE

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SEC APPROVES STOCK EXCHANGE CIRCUIT BREAKERS

1 The other stock exchanges include the American Stock Exchange, Inc., the Boston Stock Exchange, Inc., the Chicago Stock Exchange, Inc., and the Philadelphia Stock Exchange, Inc. 2 Securities and Exchange Commission Release No. 34-39846 (April 9, 1998), 63 Fed. Reg. 18447 (April 15, 1998). 3 See note 16 of the SECGs release for a description of how this information will be disseminated. [9843] April 16, 1998 TO: ACCOUNTING/TREASURERS MEMBERS No. 7-98 OPERATIONS MEMBERS No. 11-98 SEC RULES MEMBERS No. 27-98 TRANSFER AGENT ADVISORY COMMITTEE No. 24-98 EQUITY MARKET TASK FORCE RE: SEC APPROVES STOCK EXCHANGE CIRCUIT BREAKERS ____ The Securities and Exchange Commission recently approved proposed changes to the rules of the New York Stock Exchange ("NYSE"), certain other stock exchanges1 (collectively, the "Exchanges") and the National Association of Securities Dealers, Inc. relating to certain market-wide "circuit breaker" provisions that halt market trading upon the occurrence of a decline in the Dow Jones Industrial Average ("DJIA").2 The rule changes, which became effective on April 15, 1998, are intended to address concerns that the prior trigger levels of 350 point and 550 point declines of the DJIA were too low and unresponsive to dynamic market conditions. The SECGs release approving these rule changes is attached. Trigger Levels -- The revised Exchange rules establish new circuit breaker trigger levels for a one-day decline of 10%, 20% and 30% of the DJIA. These levels will be calculated at the beginning of each calendar quarter using the average closing value of the DJIA for the previous month to establish specific point values for the quarter.3 Each trigger will be rounded to the nearest 50 points. Trading Halts -- Under the new rules, trading on the Exchanges will be halted as follows: (1) Before 2:00 p.m. Eastern Time, the halt for a 10% decline will be one hour. At or after 2:00 p.m. but before 2:30 p.m., the halt will be for one-half hour. If the 10% trigger value is reached at or after 2:30 p.m., the market will not halt at the 10% level and will continue trading. (2) The halt for a 20% decline will be two hours if triggered before 1:00 p.m. At or after 1:00 p.m., but before 2:00 p.m., the halt will be for one hour. If the 20% decline occurs at or after 2:00 p.m., trading will halt for the remainder of the day. 4 The Chicago Mercantile ExchangeGs proposal does, however, diverge from the proposals of the securities markets and other futures markets in one manner. The CMEGs proposal calls for a 20% price limit to remain in effect even after the equity markets have reopened following a trading halt due to a 20% decline in the DJIA. In other words, the CME will not let futures prices fall below 20% even if the securities markets reopen after a 20% drop and then drop the maximum 30%. The CMEGs also has proposed to amend its margining procedures so that a stock index futureGs daily variation margin payment is capped at 20%, regardless of whether the underlying stock market has declined beyond 20%. This raises the possibility of a mismatch between the margin and capital treatment of

a stock index option position and its futures hedge. The SEC has urged the CME to reconsider its proposal to cap variation margin at 20% or to work out an alternative margining procedure with the options exchanges. Nevertheless, the SEC still believes that the CMEGs circuit breaker trading halt rule is substantively identical to the securities marketsG circuit breaker proposals. (3) If the market declines by 30% at any time, trading will be halted for the remainder of the day. Other Markets -- The ExchangesG rule changes are contingent on other markets adopting substantively identical proposals. The SEC notes that all existing U.S. stock and options exchanges, as well as the NASD, have either submitted revised circuit breaker pilot programs to reflect the NYSE proposal or have agreed to comply with the provisions of such programs. The futures exchanges are also adopting complementary trading halts to maintain the existing coordinated means to address potentially destabilizing market volatility.4 Amy B.R. Lancellotta Senior Counsel Attachment Note: Not all recipients of this memo will receive an attachment. If you wish to obtain a copy of the attachment referred to in this memo, please call the Institute's Library Services Division at (202)326- 8304, and ask for this memo's attachment number: 9843.
