

**MEMO# 9678**

February 13, 1998

## **SEC AND ICI POSITIONS ON MARKET CIRCUIT BREAKERS; NYSE PROPOSAL**

1 Testimony of Arthur Levitt, Chairman, U.S. Securities and Exchange Commission, Concerning Circuit Breakers, Before the Subcommittee on Securities, Committee on Banking, Housing, and Urban Affairs, United States Senate, January 29, 1998. [9678] February 13, 1998 TO: BOARD OF GOVERNORS No. 7-98 SEC RULES COMMITTEE No. 12-98 RE: SEC AND ICI POSITIONS ON MARKET CIRCUIT BREAKERS; NYSE PROPOSAL

There have been several recent developments regarding market circuit breakers. On January 29, the Subcommittee on Securities of the Senate Committee on Banking, Housing, and Urban Affairs held hearings on circuit breakers at which SEC Chairman Levitt testified. In addition, on February 5, the New York Stock Exchange ("NYSE") approved an amendment to its rules governing circuit breakers. The Institute expressed the industry's views on circuit breakers in a January 27 letter to Chairman Levitt and subsequently filed a Statement for the Record before the Senate Banking Committee. A copy of each of these items is attached and summarized below. SEC Chairman Levitt's Testimony In his testimony before the Senate Subcommittee on Securities, Chairman Levitt summarized recent market events and recommended certain changes to the circuit breaker rules.<sup>1</sup> First, Levitt recommended that circuit breakers be triggered only in extraordinary circumstances, such as in "a severe market decline where prices dropped so dramatically that liquidity and credit dry up or when prices threaten to cascade in a panic-driven spiral." He expressed concern that mutual funds be able to calculate daily net asset values using current prices, and warned that because the world markets look to the U.S. financial markets for leadership, closing the markets at any time risks creating the impression that the U.S. markets cannot function. Second, Levitt recommended that the current circuit breaker trigger points be raised. He noted the Commission's interest in proposals that would change the limits from a fixed point amount to a point amount based upon a percentage drop in the Dow Jones Industrial Average ("DJIA"), and stated that because of advances in technology, the exchanges should reevaluate their circuit breaker rules periodically and make changes as appropriate. Finally, Levitt recommended that the markets have an orderly close every day. He explained that the purpose of the circuit breakers is to provide a brief pause in trading, rather than to halt trading for the day. Levitt noted that some attempt should be made to reopen the markets closed by circuit breakers, even if the circuit breakers are triggered late in the trading day. He explained that because mutual fund investors have come to rely on the markets being open until 4:00 p.m., early closes that

<sup>2</sup> See SEC Form 19b-4, Proposed Rule Change by New York Stock Exchange, Inc., SR-NYSE-98-06, dated February 5, 1998. <sup>3</sup> Letter from Matthew Fink, President, Investment Company Institute, to the Honorable Arthur J. Levitt, Jr., Chairman, U.S. Securities and Exchange Commission, dated January 27, 1998. <sup>4</sup>

Statement for the Record Before the Senate Banking Committee By the Investment Company Institute on Market Circuit Breakers, dated February 11, 1998. prevent them from making their trades at that dayGs net asset value could undermine their confidence in the financial markets. NYSE Rule Proposal On February 5, the NYSE Board of Directors approved amendments to NYSE Rule 80B that would increase the circuit breaker levels to ten, twenty and thirty percent of the DJIA.<sup>2</sup> The NYSE proposal, which is subject to SEC approval and which focuses on percentages rather than strictly on points, was motivated by the circuit breakersG first-ever activation on October 27, when the exchange was shut down when the Dow industrials fell 554.26 points, which set off the 550 point trigger. The NYSE proposal is as follows: (1) a ten percent drop would halt trading for one hour if it occurred before 2:00 p.m., and for thirty minutes if it occurred between 2:00 and 2:30, but would not halt trading at all after 2:30; (2) a twenty percent drop occurring before 1:00 p.m. would halt trading for two hours, and between 1:00 p.m. and 2:00 p.m. for one hour, and close the market for the day after 2:00 p.m.; and (3) a thirty percent drop would close the market for the day no matter when it occurred. Institute Positions 1. Institute Letter to Chairman Levitt In light of recent activity in the securities markets that resulted in the premature closing of the securities exchanges, the Institute, in a letter to SEC Chairman Levitt, recommended modifying the rules governing circuit breakers.<sup>3</sup> The letter supported the agreement reached among the exchanges to increase the current levels of 350 points and 550 points of the DJIA to ten percent and twenty percent of the DJIA, respectively. The letter expressed concern, however, that this modification could still result in a premature closing of the market in the event the second trigger occurs. In the event of extraordinary market volatility, as would be the case if the circuit breakers were triggered, the letter stressed that it is critical that the markets remain open for a sufficient period of time at the end of the day (e.g., an hour) in order to allow the markets to stabilize. The letter emphasized that markets should remain open for trading until 4:00 p.m. each trading day, and cautioned that to do otherwise, could be harmful to the millions of mutual fund shareholders who have come to expect that orders placed up until that time will get that dayGs net asset value. 2. Institute Statement for the Record In a Statement for the Record before the Senate Banking Committee, the Institute expressed its views on the market circuit breakers and the NYSE proposal, noting its support of the NYSEGs proposed increase in circuit breaker levels.<sup>4</sup> The statement, which echoes many of the InstituteGs comments made in the letter to Chairman Levitt, summarized above, pointed out that basing the levels on percentage changes in the market rather than on specified point changes will ensure that the triggering points correspond to significant changes in the markets. Although agreeing that raising the levels at which the market would close would minimize the potential for premature closings, the statement reiterated the view that any trading halt that would cause the markets to close earlier than the normal 4:00 p.m., as would be the case under the NYSE proposal, should be avoided. We will keep you informed of further developments. Amy B.R. Lancellotta Associate Counsel Attachments

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