

May 20, 2010

New Circuit Breaker Proposed for Individual Stocks

The equity exchanges and FINRA have proposed a uniform market-wide suspension of trading on individual securities contained in the Standard & Poor's 500 Index (S&P 500) that experience a 10% or greater price change within a five-minute period. The proposals from the equity exchanges and FINRA (respectively, the "Exchange Proposals" and the "FINRA Proposal") were made in consultation with Securities and Exchange Commission (SEC) staff in response to the market volatility of May 6, 2010. According to SEC Chairman Mary Schapiro, circuit breakers for individual stocks across securities exchanges "would help to limit significant volatility. They would also increase market transparency, bolster investor protection, and bring uniformity to decisions regarding trading halts in individual securities."¹

Summary of Proposals

Under the Exchange Proposals, a trading "pause" would be triggered in the event an exchange-listed stock experiences a 10% or greater price change within a five-minute period.² Listing markets will calculate price moves by comparing each last consolidated sale price to transaction prices during the preceding five-minute period on a continuously rolling basis. The relevant exchange would have discretion to decline to use a particular transaction price in calculating price changes if such price resulted from an erroneous execution. If a trading pause is triggered, the listing exchange would immediately notify the single plan processor responsible for the consolidation of information about the stock. Each exchange would also pause trading in a security when such security's listing market suspends trading on the security.

Trading would also be halted in the over-the-counter (OTC) market. FINRA has proposed to "halt trading by FINRA members otherwise than on an exchange where a primary listing market has issued a trading pause due to extraordinary market conditions."³ The FINRA halt would be in effect until trading has resumed on the primary listing market

¹ Press Release, Securities and Exchange Commission, SEC to Publish for Public Comment Stock-by-Stock Circuit Breaker Rule Proposals (May 18, 2010), available at <http://sec.gov/news/press/2010/2010-80.htm> (the "SEC Press Release").

² The exchange proposals are substantially similar. For examples, please see NASDAQ, Inc., Form 19b-4 Proposed Rule Change by NASDAQ Stock Market (May 18, 2010), available at <http://www.nasdaq.com/about/SR-NASDAQ-2010-061.pdf>; New York Stock Exchange, Inc., Form 19b-4 Proposed Rule Change by New York Stock Exchange (May 18, 2010), available at [http://apps.nyse.com/commdata/pub19b4.nsf/docs/5DA59751D55644AF852577270076DDD3/\\$FILE/NYSE-2010-39.pdf](http://apps.nyse.com/commdata/pub19b4.nsf/docs/5DA59751D55644AF852577270076DDD3/$FILE/NYSE-2010-39.pdf).

³ FINRA, Form 19b-4 Proposed Rule Change by Financial Industry Regulatory Authority (May 18, 2010), available at <http://www.finra.org/web/groups/industry/@ip/@reg/@rulfil/documents/rulefilings/p121501.pdf>.

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or after at least 10 minutes have passed and trading has recommenced on at least one other national securities exchange. The FINRA Proposal would apply to transactions on all alternative trading systems (i.e., “dark pools” and electronic communication networks) and any other execution in the OTC market.

The Exchange and FINRA Proposals do not by their terms apply to transaction in stock options. However, a trading pause that occurs with respect to an individual equity security would likely lead to a trading halt in the related option. In this regard, the options exchanges already have rules in place allowing them to suspend trading on an option in the interests of a “fair and orderly” market. One of the factors to be considered in such determination includes when trading in the underlying security has been suspended in the primary market. See, e.g., NYSE Arca Rule 6.65 and Chicago Board Options Exchange Rule 6.3.

Timeframe of Trading Halt

Any trading pause under the proposed rules would remain in effect for five minutes, unless a “significant imbalance” exists at the end of the pause, in which case the listing market would delay the recommencement of trading on the security. Under the FINRA and Exchange Proposals, each exchange would notify other markets in the event it is unable to reopen due to a cause unrelated to such an imbalance, so that other markets may resume trading. The proposed rules would be in effect from 9:45 a.m. to 3:35 p.m. EST so that the markets could absorb the opening price of a security and allow participation in the closing process.

Pilot Period

The FINRA and Exchange Proposals call for a pilot period in which the proposed rules would be implemented until December 10, 2010, and request that the SEC approve the proposed rules in time for the pilot to be operative June 7 and with full implementation across all stocks by June 14.

In the May 18 press release about the proposed rules, the SEC stated that “markets will use the pilot period to make appropriate adjustments to the parameters or operation of the circuit breaker as warranted based on their experience, and to expand the scope to securities beyond the S&P 500 (including ETFs) as soon as practicable.”⁴ Further, SEC staff will, during the pilot period, further examine (i) how to address the risks of market orders with regard to market volatility; (ii) ways to deter or prohibit market-makers’ use of “stub” quotes; and (iii) the impact of other protocols of the securities exchanges.⁵

Comment Period

The SEC has announced that the comment period for the FINRA and Exchange Proposals will be 10 days from each proposal’s publication in the Federal Register.

⁴ The SEC Press Release.

⁵ The SEC Press Release.

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