Retirement Income
JOURNAL

The SEC approves new circuit breakers to control market volatility

By Editor Test *Thu, Jun 14, 2012*

Two new mechanisms are intended to update existing attempts to control extreme volatility by tightening trading bands and reducing trigger points. The exchanges and FINRA are slated to install both circuit breakers by February 4, 2013 on a pilot basis for one year.

Two proposals submitted by the national securities exchanges and FINRA (Financial Industry Regulatory Authority) to address extraordinary volatility in individual securities and the broader U.S. stock market have been approved by the Securities and Exchange Commission, according to an SEC release.

The first initiative would establish a “limit up-limit down” mechanism that keeps trades within a specified price band. It is meant to replace the single-stock circuit breakers installed on a pilot basis after the so-called “flash crash” of May 6, 2010.

The new circuit breaker would be set at a percentage level above and below the average price of the security over the prior five minutes of trading. The percentage would be 5% for more liquid securities in the S&P 500, the Russell 1000, and certain exchange-traded products. It will be 10% for other securities.

The second initiative lowers the percentage-decline threshold for halting all U.S. exchange-listed securities on a market-wide basis. It also shortens the amount of time that trading is halted. This circuit breaker will replace one adopted in October 1988, which was triggered once, in 1997, but failed to go off during the May 2010 crash.

“The initiatives we approved are the product of a significant effort to devise a sophisticated, yet workable and effective way to protect our markets from excessive volatility,” said SEC Chairman Mary L. Schapiro.

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