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November 30, 2015

The Honorable Mary Jo White
Chair
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549

Re: *Action to Address the Market Structure Concerns Revealed on August 24, 2015*

Dear Chair White:

On behalf of our members,[1] I respectfully write to urge you to take steps to address the market structure challenges that contributed to the disturbing events of August 24, 2015.[2] Specifically, I commend your attention to those idiosyncrasies in the operation of the exchanges that create avoidable confusion and uncertainty and contribute to market volatility. We ask that you direct efforts to address a lack of harmonization in at least three key areas.

First, the severe price disruptions in the U.S. equity market on August 24 exposed flaws in the limit up-limit down mechanism, including inconsistencies across markets for re-opening trading in a security after a trading halt. The attached *ICI Viewpoints* article describes how different re-opening processes exacerbated volatility on that day. We believe that the SEC should direct the securities exchanges, with appropriate oversight from your staff, to work together to harmonize their electronic trading procedures, including the re-opening process.

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[1] The Investment Company Institute (ICI) is a leading, global association of regulated funds, including mutual funds, exchange-traded funds, closed-end funds, and unit investment trusts in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI's U.S. fund members manage total assets of $17.1 trillion and serve more than 90 million U.S. shareholders.

[2] We concur with the growing consensus that the configuration of U.S. equity market structure rather than flaws in the design of the affected exchange-traded products caused these halts. *See* Remarks of Thomas Farley, President of NYSE Group, at the October 27 Meeting of the Equity Market Structure Advisory Committee, available at https://www.sec.gov/news/otherwebcasts/2015/equity-market-structure-advisory-committee-102715.shtml; *see also* Remarks of Chris Concannon, President and CEO of BATS, at the October 15, 2015 Meeting of the Investor Advisory Committee, available at https://www.sec.gov/news/otherwebcasts/2015/investor-advisory-committee-101515.shtml.

Second, we also believe that the securities exchanges should reconsider the operation of their clearly erroneous trade rules in conjunction with the limit up-limit down price bands. The multiple "reference prices" and "band" triggers that exist today unduly add complexity to the system when simplicity and clarity would help calm an already tumultuous market.

Finally, the SEC should work with other regulators, in particular the Commodity Futures Trading Commission, to ensure that market halts are implemented consistently across markets, including the futures markets. These markets are interdependent (as many market participants may rely on both the equity and futures markets to hedge their positions), and regulators should scrutinize how an inconsistent approach to these trading halts could impede the ability of participants to use these markets effectively.

As important participants in the equity market, ICI members have a strong interest in ensuring that the regulatory structure that governs the market allows for the most orderly, efficient and competitive market possible. I therefore respectfully urge the SEC and the securities exchanges to consider closely these and other perspectives of buy-side participants in making necessary changes, including making necessary amendments to the limit up-limit down mechanism. The work of the limit up-limit down operating committee would be far better informed if it included the perspectives of a broader group of market participants, including funds and their managers. To our knowledge, however, this critical committee does not include any ICI member or any other asset manager.

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We deeply appreciate your leadership in reviewing the operation of the equity markets to ensure that those markets are performing as efficiently as possible, including during periods of market volatility. We and our members stand ready to assist you, your staff and the exchanges in these efforts. If you have any questions on our letter, please feel free to contact me at (202) 326-5901 or have your staff contact David Blass at (202) 326-5815 or Jennifer Choi at (202) 326-5876.

Sincerely,

With kindest regards. Paul Stevens.

Paul Schott Stevens
President & CEO
Investment Company Institute

Attachment

cc: The Honorable Luis A. Aguilar, Commissioner, SEC
The Honorable Kara M. Stein, Commissioner, SEC
The Honorable Michael S. Piwowar, Commissioner, SEC
Stephen Luparello, Director, Division of Trading and Markets, SEC
Gary Goldsholle, Deputy Director, Division of Trading and Markets, SEC
David Shillman, Associate Director, Division of Trading and Markets, SEC

INVESTMENT COMPANY INSTITUTE®

Traders, Start Your Engines: After August 24, Exchanges Need to Coordinate

By Jennifer Choi and George Gilbert

November 30, 2015

The extraordinary volatility in U.S. equity markets on August 24, 2015, exposed a significant deficiency in the rules governing these markets' structure: a lack of harmonization across securities exchanges for reopening trading after a "limit up–limit down" trading halt in a security.

In a nutshell, marketwide rules implemented after the May 2010 "flash crash" succeeded in moderating the U.S. markets' response to the day's bad economic news and turmoil in Asian markets. But the rules left out a key element: they don't require exchanges to harmonize their rules for reopening trading after a trading halt. The lack of coordination across exchanges after a trading pause may have contributed to that day's volatility. To fix that problem, the securities exchanges must work together to establish a uniform process for reopening trading in a security after a limit up–limit down trading halt.

A Bad Start That Got Worse

Monday, August 24 began with bad news: a sell-off in Asian equities that spread to other markets. Many investors in U.S. equity markets knew they could be in for a rough day, but few envisioned the chaos that the first hour of trading would bring. Severe price moves in hundreds of securities—including exchange-traded products (ETPs)—triggered more than 1,300 trading halts. In some cases, these halts occurred within a minute of the commencement or reopening of trading.

The halts were the result of limit up–limit down rules implemented in the aftermath of the flash crash of May 6, 2010. These rules are intended to prevent a security from trading at a price outside specified price bands, and are coupled with trading pauses to accommodate more fundamental price moves.

Because many of the halts involved ETPs, some market participants and observers have raised questions over whether the structure of ETPs somehow contributed to the day's extreme volatility. But exchange leaders—including Thomas Farley, president of NYSE Group, and Chris Concannon, president and CEO of BATS Global Markets—have concluded that flaws in the trading rules for U.S. equity markets, rather than the design of the affected ETPs, were responsible for the wild ride of August 24. We agree with this growing consensus.

A Different Story

The limit up–limit down rules did work—they provided an effective, uniform mechanism for halting trading in specific securities during a time of market volatility. But reopening trading was quite a different story.

The limit up–limit down rules rely on the exchanges to reopen trading, but the rules of the securities exchanges are not coordinated. For example, the NYSE Arca uses an auction to reopen trading in a security following a trading halt, and imposes "collars" on the reopening price to ensure that it falls within a specified range of the last price for that security. Other exchanges use different methods to establish the reopening price. Moreover, different exchanges have different rules on how to handle orders after a trading halt: some send orders back to brokers, while others hold the orders until the primary market reopens trading in the security.

These varied processes affect the trading of a security immediately after a reopening, adding to confusion and uncertainty during times of stress—exactly when clarity and certainty are most important.

As the unnerving events of August 24 demonstrated, this source of unpredictability must be addressed. Securities exchanges must get together to work out a uniform process to reopen trading in a security after a limit up–limit down trading halt. The exchanges also must adopt a uniform method of handling orders after a trading halt. And to improve price discovery after a trading halt, all orders should be routed to the primary market that is reopening the halted security.

ICI and its members stand ready to assist the SEC and the exchanges in making the necessary adjustments to market structure that will best serve investors.

Jennifer Choi is associate general counsel, and George Gilbert is counsel, at ICI.
