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SECURITIES & CORPORATE COUNSEL

Legal Risk Management Tip
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SEC AND CFTC RESPOND TO THE MARKET DISRUPTION

As a result of the recent market disruption on May 6, 2010, the Securities and Exchange Commission ("SEC") and the Commodities Futures Trade Commission ("CFTC") have taken joint steps to both examine the cause of the unusual market activity and to collaborate in hopes of preventing or minimizing such future occurrences. The SEC has taken several related actions this month in response to the market disruption which includes the formation of a new committee and the proposed creation of new market protections.

Earlier this month, the market experienced dramatic fluctuations in a short period of time when approximately 30 Standard and Poor's 500 ("S&P 500") stocks dropped in price by at least 10% in a five minute period, only to recover a short time later.[1]

In its first collaborative announcement this month on May 6th, the SEC and the CFTC jointly announced that they would review together the "unusual trading activity" in conjunction with other industry regulators.[2] The SEC and CFTC stated particularly at that time their intention to make recommendations related to any market structure issues that may have contributed to the unusual market activity.

Several days later, the SEC and the CFTC announced the formation of a joint advisory committee that is designed to address emerging regulatory issues.[3] The announcement by SEC Chairman Mary Schapiro and CFTC Chairman Gary Gensler was not a surprise to the industry due to the fact that a report last year recommended the formation of such a committee as one of several ways to harmonize the two agencies.

The name of the new committee, the *Joint CFTC-SEC Advisory Committee on Emerging Regulatory Issues*, will focus on issues that are of concern to both agencies. Reviewing the market activities of May 6, 2010, will be the first such issue.

Chairmans Schapiro and Gensler both acknowledged that a fundamental reason for the formation of the new joint committee is the interdependency of the securities and commodities markets. As these two markets continue to become more and more intertwined, activities in one market clearly tend to impact the other. Thus, the committee will focus in part on how events in one market can potentially impact investors in the other.

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[1] Press Release, Sec. & Exch. Comm'n, SEC to Publish for Public Comment Stock-by-Stock Circuit Breaker Rule Proposals (May 18, 2010) *available at* http://www.sec.gov/news/press/2010/2010-80.htm.
[2] Press Release, Sec. & Exch. Comm'n, Statement from SEC and CFTC (May 6, 2010) *available at* http://sec.gov/news/press/2010/2010-72.htm.
[3] Press Release, Sec. & Exch. Comm'n, SEC, CFTC Announce Creation Of Joint CFTC-SEC Advisory Committee On Emerging Regulatory Issues (May 11, 2010) *available at* http://sec.gov/news/press/2010/2010-75.htm.

The committee's charter is broad and tasks its members with the following:

- Identifying emerging regulatory risks;
- Assessing and quantifying the impact of such risks and their implications for investors and market participants; and
- Furthering the SEC's and CFTC's efforts on regulatory harmonization.

Schapiro and Gensler will serve as co-chairs of the joint committee, which will also include Richard Ketchum, Chairman and Chief Executive Officer of FINRA. The first open public meeting on May 24, 2010, will include a discussion of the joint CFTC-SEC findings concerning the events of May 6, 2010.[4]

A foreshadowing to this discussion occurred on May 18th when the SEC and CFTC announced their preliminary findings concerning the market disruption of May 6th.[5] The report noted that a number of events conspired to create the market conditions of the day, which began with "unsettling political and economic news from overseas" which included the European debt crisis and increased premiums for buying protection against default by the Greek government.[6] The two agencies focused on six primary factors which caused the events of the day to unfold, two of which were: (1) a severe mismatch in liquidity, and (2) the exacerbation of this mismatch by disparate trading rules among the various exchanges. As a result, trading tended to slow in one exchange while continuing as normal in another. The report did note that there was no evidence at this time that the market event was triggered by "fat finger" errors, computer hackers, or terrorist activity.[7] Further discussions on these findings will resume at the joint committee meeting on May 24th.

Significantly, the SEC also announced proposed rules that would give the agency the authority to pause certain trading where there is a price movement of 10% or more during a five-minute period.[8] The purpose of the rules is to provide a uniform standard and response when individual stocks incur a rapid price movement. In announcing the proposed rules, Chairman Schapiro focused on the notion of having "uniform circuit breakers that would be triggered when needed" across all of the markets.

The effect of the rules as proposed would be that if any S&P 500 stock incurs a 10% price fluctuation within a five minute period, trading would be paused across the entire

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[4] SEC News Digest, Issue No. 2010-91, May 18, 2010, http://www.sec.gov/news/digest/2010/dig051810.htm.

[5] PRELIMINARY FINDINGS REGARDING THE MARKET EVENTS OF MAY 6, 2010: REPORT OF THE STAFFS OF THE CFTC AND SEC TO THE JOINT ADVISORY COMMITTEE ON EMERGING REGULATORY ISSUES (May 18, 2010), *available at* http://www.sec.gov/sec-cftc-prelimreport.pdf.

[6] *Id.* at.2.

[7] *Id.* at.3.

[8] Press Release, Sec. & Exch. Comm'n, SEC to Publish for Public Comment Stock-by-Stock Circuit Breaker Rule Proposals (May 18, 2010) *available at* http://www.sec.gov/news/press/2010/2010-80.htm.

U.S. equity market for five minutes. The notion behind the pause is that it would provide the market with a brief period in which to attract new market interest in the affected stock. Consequently, this could normalize the stock's price, and regular trading would resume.

If adopted, the proposed rules would take effect as a pilot on December 11, 2010. During the pilot, the SEC would have the opportunity to make adjustments and possibly expand the scope of the rules beyond the S&P 500.

Jacko Law Group, PC will actively monitor the progression of these rule proposals and provide future updates. For more information on how these rules may impact your business, please contact Wendy Coticchia at (619) 298-2880. Thank you.

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