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July 19, 2010

Ms. Elizabeth M. Murphy  
Secretary  
Securities and Exchange Commission  
100 F Street, N.E.  
Washington, D.C. 20549

Re: Clearly Erroneous Executions (File Nos. SR-BATS-2010-16, SR-CHX-2010-13, SR-EDGA-2010-03, No. SR-EDGX-2010-03, SR-ISE-2010-62, SR-FINRA-2010-32, SR-BX-2010-40, SR-NASDAQ-2010-76, SR-NSX-2010-07, SR-NYSE-2010-47, SR-NYSEAmex-2010-60, and SR-NYSEArca-2010-58)

Dear Ms. Murphy:

The Investment Company Institute<sup>1</sup> strongly supports the concept underlying the proposed amendments, filed by the national securities exchanges and the Financial Industry Regulatory Authority (“FINRA”), to change the rules relating to clearly erroneous executions (“CEE”).<sup>2</sup> The amendments would clarify the process for breaking erroneous trades by imposing specific parameters by which trades would be broken and provide uniform treatment across the exchanges for CEE reviews. We believe, however, that the parameters proposed in the amendments may result in unintended consequences, as discussed below. We urge the

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<sup>1</sup>The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of \$11.42 trillion and serve almost 90 million shareholders.

<sup>2</sup> See SEC Release No. 62340 (June 21, 2010), File No. SR-BATS-2010-16; SEC Release No. 62336 (June 21, 2010), File No. SR-CHX-2010-13; SEC Release No. 62338 (June 21, 2010), File No. SR-EDGA-2010-03; SEC Release No. 62339 (June 21, 2010), File No. SR-EDGX-2010-03; SEC Release No. 62330 (June 21, 2010), File No. SR-ISE-2010-62; SEC Release No. 62341 (June 21, 2010), File No. SR-FINRA-2010-32; SEC Release No. 62342 (June 21, 2010), File No. SR-BX-2010-40; SEC Release No. 62334 (June 21, 2010), File No. SR-NASDAQ-2010-76; SEC Release No. 62331 (June 21, 2010), File No. SR-NSX-2010-07; SEC Release No. 62333 (June 21, 2010) File No. SR-NYSE-2010-47; SEC Release No. 62332 (June 21, 2010), File No. SR-NYSEAmex-2010-60; and SEC Release No. 62335 (June 21, 2010), File No. SR-NYSEArca-2010-58.

Commission to carefully examine the risks of the proposed numerical guidelines before approving the exchanges' and FINRA's amendments.

Under current rules, there is no clearly defined framework for breaking erroneous trades, and exchanges have discretion to choose the specific percentage threshold at which to break trades. Consequently, on May 6, exchanges broke trades that were more than 60 percent away from the "reference price"<sup>3</sup> in a process that was not transparent to market participants and did not operate in the best interest of investors. The uncertainty surrounding the CEE rules, and therefore the risks associated with entering buy orders during the downside, caused some market makers, who normally would be making two-sided markets, to step away from the market.<sup>4</sup> The absence of market makers and other professional traders<sup>5</sup> significantly reduced the supply of liquidity in the market. Specifically, their absence allowed the influx of sell orders to sweep quickly through available liquidity on the exchanges' order books in an effort to obtain an execution at any price, thereby contributing to the rapid and dramatic May 6 market decline.

By making it clearer when, and at what prices, trades would be broken, the proposed amendments would provide greater certainty to market makers and other traders of the CEE review process, and should reduce the frequency with which these market participants step away from the market in times of stress. The amendments also would limit the exchanges' discretion to diverge from the established procedures and numerical guidelines in the rules, again providing greater certainty to market participants.

Some members, however, have highlighted concerns with the specific parameters for breaking trades in the proposed CEE amendments. For example, there may be the potential for manipulation in events involving multiple stocks that are not subject to the single stock circuit breaker pilot program.<sup>6</sup> The proposed amendments would break trades that are at least 10 percent away from the reference price for market events involving between five and twenty

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<sup>3</sup> The "reference price" is typically the last sale before pricing is disrupted.

<sup>4</sup> See Letter from Karrie McMillan, General Counsel, Investment Company Institute, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, dated June 3, 2010 ("ICI June 2010 Letter"). See also, Statement of Leonard J. Amoruso, Senior Managing Director and General Counsel Knight Capital Group, Inc., before the CFTC-SEC Advisory Committee on Emerging Regulatory Issues, June 22, 2010, available at <http://www.sec.gov/comments/265-26/265-26-20.pdf>. Market makers have anecdotally indicated to members that as a price approaches a decline of 10 percent from opening, they will step away to avoid being exposed to negative selection (when one side of a hedge transaction is completed, while the other side is cancelled, leaving the trader exposed).

<sup>5</sup> Other professional traders, such as high frequency traders, have no obligation or incentive to trade during times of market stress. See ICI June 2010 Letter.

<sup>6</sup> See SEC Press Release 2010-98, *SEC Approves New Stock-by-Stock Circuit Breaker Rules*, dated June 10, 2010, available at <http://www.sec.gov/news/press/2010/2010-98.htm>.

stocks and at least 30 percent away for events involving more than twenty stocks. Presumably, the use of a larger percentage for events involving more than twenty stocks is designed to accommodate price discovery in broader market events. What is to prevent a market participant, however, from forcing a market event into the 30 percent category by manipulating the stock of a twenty-first stock, in order to have the flexibility to trade at wider spreads with respect to the twenty-one stocks affected by the market event? We do not believe it would be difficult or costly to compel this outcome because of the advances in trading technology and the potentially small amount of capital that would be required to push down the price of a single stock.

We also request that the Commission require the exchanges and FINRA to provide clarity in the proposed amendments regarding the application of the CEE rules intra-day. For example, if a market decline triggers the CEE rules intra-day with respect to a stock that was priced at \$25.01, so the CEE price is below \$25, the proposed amendments do not explain at what price trading would be calculated for the next potential application of the CEE rules. Would it be at 5 percent for stocks between \$25 and \$50 or 10 percent for stocks priced at less than \$25?

While we support the proposed amendments, we note that the changes only address the procedural component of the CEE rules. The amendments do not speak specifically to the use of the rules by market participants. Members report that market participants often seek to use the rules to break trades that are disadvantageous to them, as opposed to “clearly erroneous.” Further, some exchanges do not rigorously review CEE claims and regularly grant the request to break trades. We encourage the Commission to ensure that exchanges are vigilant in ascertaining that trades are broken only when truly erroneous –*i.e.*, obviously incorrect or resulting from extraordinary market conditions or circumstances in which the cancellation of the trade is necessary to maintain a fair and orderly market or to protect the public interest. Otherwise, the uncertainty surrounding the rules will continue to plague the markets.

Finally, we note that the proposed amendments complement last month’s Commission approval of a uniform set of single stock circuit breakers.<sup>7</sup> We commend the Commission, the exchanges, and FINRA for their efforts to quickly address problems in our current market structure which contributed to the events of May 6. In moving forward, we reiterate to the Commission our belief in the importance of addressing without delay other inefficiencies in our current market structure and in doing so with holistic solutions where possible.

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<sup>7</sup> *Id.*

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If you have any questions on our comment letter, please feel free to contact me directly at (202) 326-5815, Ari Burstein at (202) 371-5408 or Heather Traeger at (202) 326-5920.

Sincerely,

/s/ Karrie McMillan

Karrie McMillan  
General Counsel

cc: The Honorable Mary L. Schapiro  
The Honorable Kathleen L. Casey  
The Honorable Elisse B. Walter  
The Honorable Luis A. Aguilar  
The Honorable Troy A. Paredes

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