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ES 135094

June 22, 2010

The Honorable Mary L. Schapiro
Chairman
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

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CHAIRMAN'S
CORRESPONDENCE UNIT

Re: Inclusion of ETFs in Single-Stock Circuit Breaker Pilot Program

Dear Chairman Schapiro:

I am writing to express our serious concerns regarding what we understand to be an issue concerning the inclusion of certain exchange-traded funds ("ETFs") in the next phase ("Phase II") of the single-stock circuit breaker pilot program. Specifically, we understand that while the national securities exchanges and the Financial Industry Regulatory Authority ("FINRA") have no objections to including ETFs whose baskets substantially include those individual securities that are the subject of the pilot program, objections raised by one of the futures exchanges (*i.e.*, the Chicago Mercantile Exchange, or "CME") may prevent certain of these ETFs from being included in Phase II of the pilot.

We have held several conversations with the CME to better understand its concerns. We believe its objections focus on a select group of ETFs that are the most highly correlated to the indices that are and will be the subject of the pilot program, *i.e.*, certain ETFs that track the S&P 500, the Russell 1000, the Dow Jones Industrial Average and the Nasdaq 100.^{*} The CME expressed concerns to us about the impact on the futures market of a slowdown in the trading of these ETFs; because it views these ETFs to be more akin to a market-based product and not an individual security, it stated that these ETFs should not be subject to a stock-by-stock circuit breaker and should instead be subject to the parameters of a market-wide circuit breaker.

We understand the Commission's desire to move quickly to implement Phase II of the pilot program. This desire to move expeditiously, however, should not overshadow the importance of

^{*} It is unclear to us exactly how many ETFs are subject to CME's objection. In our most recent conversations with the CME, their concerns appear to have expanded to numerous ETFs that are correlated to these indices.

making informed and reasoned regulatory decisions and should not put unfairly at risk a particular segment of exchange-traded products.

As you know, ETF trades comprised approximately seventy percent of the trades cancelled on May 6, according to the joint CFTC-SEC preliminary report. While we understand that Phase II of the pilot may include numerous ETFs, not including some of the largest and most liquid ETFs whose baskets consist of individual securities that *are* the subject of the pilot could result in these ETFs suffering disproportionately should another market event similar to that of May 6 occur. As we stated in our comment letter on the first phase of the pilot program, the market price of an ETF is typically highly correlated to the market price of its basket of component securities. Under normal circumstances, ETFs will maintain this correlation even when trading has been halted for one or two component securities; when multiple underlying securities experience trading halts or slowdowns, however, the correlation between the prices of an ETF and its underlying basket may experience more severe dislocation, as was illustrated on May 6. This scenario could repeat itself if circuit breakers on several securities in the basket are triggered before ETFs containing those securities are included in the pilot program.

In addition, regulators and market participants in general are still trying to understand why ETFs suffered a disproportionate amount of cancelled orders on May 6; it is unclear how excluding certain ETFs would benefit this examination.

We appreciate the need to examine the impact of circuit breakers across all exchange-traded instruments whose value is correlated to securities included in the pilot, such as futures and options. To this end, we urge the Commission to review promptly the current market-wide circuit breakers and work with other regulators and the markets to implement revised and coordinated market wide circuit breakers as necessary. Additionally, while we believe it is appropriate for the pilot program to apply the same circuit breaker triggers to ETFs initially (*i.e.*, ten percent change in price over the preceding five minutes), we are open to examining whether a different circuit breaker trigger is appropriate for ETFs generally, or for a segment of ETFs. With that said, given the time sensitivity for implementing the next phase of the pilot program, we urge the Commission to ensure that all ETFs whose baskets substantially contain the individual securities subject to the pilot program be included in the Phase II of the pilot.

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June 22, 2010
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Thank you for your consideration of our concerns. If you have any questions, or if we can provide any additional information, please do not hesitate to contact me at (202) 326-5901.

With very best regards.

Sincerely,

A handwritten signature in black ink, appearing to read 'Paul Schott Stevens', written over a large, stylized 'P'.

Paul Schott Stevens
President and CEO

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

Robert W. Cook, Director
James Brigagliano, Deputy Director
Division of Trading and Markets

Andrew J. Donohue, Director
Division of Investment Management
U.S. Securities and Exchange Commission

The Honorable Gary Gensler, Chairman
Commodity Futures Trading Commission

Craig S. Donohue, Chief Executive Officer
Chicago Mercantile Exchange