June 2, 2010

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New York, New York 10055

VIA ELECTRONIC FILING

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

Re: SRO Single Stock Circuit Breaker Proposals (File Nos. SR-BATS-2010-014, SR-BX-2010-037, SR-NASDAQ-2010-061, SR-NSX-2010-05, SR-NYSE-2010-39, SR-NYSEArca-2010-41, SR-NYSEAmex-2010-46, SR-ISE-2010-48, SR-EDGA-2010-01, SR-EDGX-2010-01, SR-CBOE-2010-047, SR-FINRA-2010-025)

Dear Ms. Murphy:

This letter responds to the request of the Securities and Exchange Commission (the "Commission") for comments on the proposed single stock circuit breakers filed by the national securities exchanges and the Financial Industry Regulatory Authority in response to the market events of May 6, 2010. BlackRock[1] commends the Commission for seeking to implement trading pauses for individual securities in times of market stress. We believe such trading pauses may reduce market volatility resulting from temporary supply-demand imbalances without unduly interrupting market price discovery. BlackRock strongly supports single stock circuit breakers.

While the proposed circuit breakers are a useful and necessary first step, single stock circuit breakers alone will not solve the structural deficiencies evidenced by the market events of May 6. Other inefficiencies in the current market structure highlighted by the events of May 6 also must be addressed for single stock circuit breakers to be fully effective. BlackRock respectfully asks that the Commission continue to focus on other potential solutions to the structural flaws evidenced on May 6, which BlackRock believes include:

[1] BlackRock is the world's largest investment manager, with over $3 trillion in assets for thousands of clients around the world. BlackRock is solely in the business of providing investment advice to clients, including institutions, individuals and regulated investment funds. A BlackRock subsidiary is the investment adviser to the iShares family of exchange-traded funds ("ETFs"), which, as of April 30, 2010, was the largest family of ETFs in the U.S., with over 200 ETFs and over $390 billion in aggregate assets invested in U.S. equity, international equity, and a variety of fixed-income asset classes.

- **<u>Exchange Trade Error Cancellation Rules</u>** are vague and inconsistently applied. Not only does trade error cancellation appear arbitrary to the investing public, but BlackRock believes the rules themselves appear to have aggravated the steep decline in stocks, particularly certain ETFs, seen on May 6.[2] BlackRock has been informed by a number of large liquidity providers that when the steep decrease in U.S. equity values neared 10% -- a level specified as a "reference" in exchange erroneous trade rules[3] -- the liquidity providers steeply discounted or ceased their bids for ETFs. This is because the so-called "arbitrage mechanism" of ETFs[4] requires liquidity providers to sell a basket of stocks equivalent to an ETF's underlying portfolio (or a correlated derivative) as a hedge when purchasing ETF shares. Fearing possible trade cancellations in the hedging transactions, the liquidity providers pulled back from bidding for shares of ETFs that owned high percentages of stocks perceived as vulnerable to cancellations rather than risk being significantly unhedged if stock transactions were in fact cancelled. It is critical that exchange trade error cancellation rules be made less arbitrary and more transparent in a manner that does not discourage liquidity providers from providing liquidity at times of market stress. BlackRock encourages the Commission to consider working with the exchanges to eliminate existing trade error cancellation rules in favor of replacement rules that impose price bands similar to those that appear to work well in futures markets.[5]

- **<u>The Use of Stop Loss and Market Orders</u>** appear to have contributed to trade executions occurring at irrational levels. These types of orders appear to have added selling pressure to a declining market and may not provide investors who submit such orders with the benefits they are seeking. BlackRock believes there would be a benefit in a review by the Commission of order types and their uses. In particular, BlackRock believes the Commission should consider requiring stop loss orders to specify a limit price.

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[2] *See* "Trading Firms Break a Sweat Over Breaking Trades", Marketwatch.com, publicly available at http://www.marketwatch.com/story/trading-firms-break-a-sweat-over-breaking-trades-2010-05-17.

[3] *See, e.g.,* NYSE Rule 128, "Clearly Erroneous Executions for NYSE Equities", NYSE ARCA Rule 7.10, "Clearly Erroneous Executions" and NASDAQ Equity Rule 11890, "Clearly Erroneous Transactions", which contain "numerical guidelines" for determining "erroneous" executions. Under these guidelines, 10% is the reference point for determining whether a "multi-stock event" during regular market hours may be erroneous.

[4] *See* <u>Exchange-Traded Funds, Release No. IC-28193, File No. S7-07-08</u> (March 11, 2008) (the "ETF Rule Proposal") and Letter from Ira P. Shapiro, Associate General Counsel of Barclays Global Fund Advisors (since renamed BlackRock Fund Advisors, a BlackRock affiliate) to Nancy M. Morris dated May 16, 2008 commenting on the ETF Rule Proposal (the "iShares ETF Rule Comment Letter").

[5] Both CME Globex and the ICE Trading System automatically reject orders priced outside of an established price band (generally approximately 1% above or below the last executed trade), and triggered stop loss orders are treated as limit orders executable only down to the low end of the price band. This appears to prevent off-market executions while eliminating the uncertainty caused by the potential for trade cancellations and permitting price discovery. *See* Report of the Staffs of the CFTC and SEC to the Joint Advisory Committee on Emerging Regulatory Issues, Preliminary Findings Regarding the Market Events of May 6, 2010, dated May 18, 2010 (the "Preliminary Joint Report"), available at http://www.sec.gov/sec-cftc-prelimreport.pdf, at page Appendix B-11. Securities markets could establish effective price bands at circuit breaker levels. This means that any trades in a security executed below levels that would trigger a circuit breaker for the security would be deemed to have occurred at the circuit breaker level. If the market for the security re-opens at a lower level following the circuit breaker, the next circuit breaker level would become the effective low-end of the price band.

- **<u>Trading Slowdowns or Halts are Not Applied Uniformly Among Exchanges</u>**, which seems to have played a significant role in market confusion and fractured markets on May 6. It is critical that any trading slowdowns or halts be applied uniformly across exchanges.

- **<u>Electronic Market Makers Lack Clear Obligations and Incentives to Maintain Orderly Markets</u>**, similar to the obligations and incentives that historically have applied to specialists trading on exchange floors. Rather, most market makers have no obligations, and those designated "lead" market makers in certain electronic markets generally only have an obligation to maintain quotations that are the "national best bid or offer" a specified percentage of time.[6]

- **<u>The Suspension of Order Routing to the Best Bid or Offer is Haphazard</u>**. During the market stress, several exchanges invoked "self help" against NYSE ARCA, the largest trading venue for ETFs. The declaration of self help allowed those exchanges to execute orders in ETFs at price levels that may have been inferior to those available on NYSE ARCA. It is not apparent that the declarations of "self help" benefitted ETF investors, as the exchanges invoking self help appear to have lacked significant depth of bid quotes on ETF shares and therefore matched market sell orders against "stub" quotations that were not intended to be executed against. There needs to be clarity and consistency in the suspension in the Best Bid or Offer across exchanges.[7]

I. Circuit Breaker Proposals

Under the proposed rules, trading in a stock would pause across U.S. equity markets for a five-minute period in the event that a stock experiences a ten percent change in price over the

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[6] *See, e.g.,* NYSE ARCA Rules 7.23, "Obligations of Market Makers" and 7.24, "Designated Market Maker Performance Standards"; BATS Exchange, Inc. Rule 11.8, "Obligations of Market Makers"; NASDAQ Equity Rule 4613, "Character of Quotations".

[7] Rule 611(a) of Regulation NMS requires, in effect, that exchanges establish and maintain policies and procedures designed to prevent executions in national market system securities other than at the best bid or offer displayed on any national market system trading venue ("protected quotations"). Rule 611(b)(1) of Regulation NMS sets forth an exception from this requirement, which we understand to be the legal basis for the declarations of self help on May 6, for quotations on an exchange "experiencing a failure, material delay, or malfunction of its systems or equipment." BlackRock has been told by other exchanges that NYSE ARCA was reporting executions with a "material delay", but NYSE ARCA has disputed this claim. It appears to BlackRock that, whatever the truth of the matter, investors were not well served by the exchanges' exclusive focus on speed of execution reporting. We recommend that the Commission consider modifying Rule 611(b)(1) to permit ignoring protected quotations only in circumstances where either (a) an exchange has communicated to the Commission and other exchanges it is experiencing material operational difficulties, or the Commission has found that to be the case, or (b) an exchange exercises "self help" in the following circumstances:

- it has concluded that routing orders to another exchange will be detrimental to investors based on factors including quality, as well as speed, of executions;
- following the decision to exercise self help, the exchange declaring self help files a statement with the Commission clearly setting forth the factors that led to the conclusion self help would be in the interest of investors; and
- the Commission would be able to review the exchange's reasoning that investors would benefit from ignoring protected quotations.

preceding five minutes. The proposed rules would apply initially, in a pilot program, only to stocks that are components of the S&P 500 Composite Stock Index (the "S&P 500").

BlackRock supports single stock circuit breakers that would apply across exchanges. BlackRock fears, however, that the proposed circuit breaker parameters – ten percent price movement over five minutes – may be too narrow. Based on our analysis of trading on May 6, BlackRock believes that circuit breakers at these levels would have resulted in halting trading in 58, or approximately 11.6% of, S&P 500 stocks. While temporarily halting trading in 58 S&P 500 may have been beneficial on May 6, the extremely rapid downward price movement experienced on May 6 suggests to BlackRock that a larger number of stocks might have benefitted from a short trading halt to establish a new market-clearing price. In contrast, a circuit breaker parameter of five percent price movement over five minutes would have temporarily halted trading in 309, or approximately 61.8%, of S&P stocks.[8]

Circuit breakers are most effective if the trading pause is used to balance available bids and offers at a new market-clearing price. The proposed rules contemplate that trading would resume either when (a) designated market makers at the primary listing exchange re-open trading, or (b) at the end of ten minutes, ***even if trading has not re-opened at the primary listing exchange due to a significant order imbalance***.[9] BlackRock supports allowing the designated market makers at the primary listing exchange to re-open trading, because BlackRock believes the designated market makers at the primary listing exchange are best positioned to establish a new market-clearing price. BlackRock has concerns about the second alternative, however, as it is not clear to BlackRock how investors would benefit from re-opening trading on other exchanges if an order imbalance continues to exist on the primary listing exchange. Indeed, the preliminary joint report of the staffs of the Commission and the Commodity Futures Trading Commission queries whether allowing trading on electronic markets while the New York Stock Exchange experienced "liquidity replenishment periods" ("LRPs") in certain stocks may have caused "a net loss of liquidity, as orders were routed to other trading venues for immediate execution rather than waiting on the LRP mechanism" to work, thus potentially causing some securities to decline further than the broad market decline.[10] BlackRock suspects the second alternative could perpetuate similar results at future times of market stress. BlackRock respectfully asks the Commission to consider whether investors would experience unwarranted unpredictability relating to the price of trade executions, similar to that experienced on May 6, if stocks are permitted to trade in

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[8] BlackRock's analysis indicates the following number of S&P 500 stocks would have hit circuit breaker levels on May 6 at the corresponding price movement levels:

Price Movement	# of Affected Stocks	
>15.0%	23	4.6%
>12.5%	32	6.4%
>10.0%	58	11.6%
>7.5%	122	24.4%
>5.0%	309	61.8%

Price Chg, in 5-min. period

Data from 2:40 to 3:00 pm, May 6

[9] *See, e.g.*, SR-BATS-2010-014, SR-EDGX-2010-01 ("If, however, trading has not resumed on the primary listing market and ten minutes have passed since the individual stock trading pause message has been received from the responsible single plan processor, the Exchange may resume trading in such stock").

[10] *See* Preliminary Joint Report at page 5.

electronic markets that may lack order depth when order imbalances exist on the primary listing exchange.

II. Inclusion of ETFs in Circuit Breaker Pilot

The May 6 market event disproportionately affected ETFs that seek to track benchmarks of U.S. stocks.[11] These ETFs appear to have suffered executions at irrational price levels to a greater extent than many stocks due to a confluence of several factors, including (a) the reluctance of liquidity providers, amid a rapid market decline, to bid for the ETFs' shares while there existed a risk that offsetting hedge sales of stocks held in the ETFs' underlying portfolios might later be cancelled by the exchanges, and (b) the declaration of self help by several exchanges against NYSE ARCA cut off orders to sell the ETFs' shares at market routed to those exchanges from accessing bids on NYSE ARCA, the primary trading venue for ETFs, thus allowing those exchanges to execute orders against bids that may have been inferior to those available on NYSE ARCA.

We believe it would be beneficial for ETFs be included in the circuit breaker pilot program as soon as possible. We are encouraged by the Commission's recognition that ETFs should soon be part of the pilot.[12] ETFs can – and often do – continue trading effectively if trading in one or more underlying stocks is halted or otherwise does not occur while the ETFs trade.[13] We believe that May 6 demonstrated, however, that ETF shares cannot be priced rationally by the market if it is not possible for market makers, liquidity providers and other sophisticated traders to assess the ETF's underlying value accurately enough to hedge trading exposures to the ETF effectively.[14] BlackRock is concerned that, if a volatility event affecting a significant proportion of an ETF's underlying holdings occurs, the ETF's shares will be unable to be priced at reasonable levels if they continue to trade while a large number of the underlying stocks are halted, potentially disrupting the ETF arbitrage mechanism. BlackRock therefore suggests that ETFs become subject to circuit breakers similar to those that apply to their underlying holdings as soon as possible. The initial pilot program should include ETFs that track the S&P 500 or other indices with substantially overlapping securities.[15]

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[11] *See* Preliminary Joint Report at page 5.

[12] *See, e.g.,* Testimony of Commission Chairman Mary L. Schapiro, Examining the Causes and Lessons of the May 6th Market Plunge, before the Subcommittee on Securities, Insurance, and Investment of the United States Senate Committee on Banking, Housing, and Urban Affairs, May 20, 2010, available at http://www.sec.gov/news/testimony/2010/ts052010mls.htm (stating that the pilot program's scope should "expand … to securities beyond the S&P 500 (including ETFs) as soon as practicable.").

[13] The holdings of most ETFs that seek to track benchmarks of non-U.S. stocks do not trade while the ETFs trade during U.S. market hours. Market makers and liquidity providers are still able to estimate the value of such holdings and to quote for shares of the ETFs. May 6 differed, however, in that the extreme, rapid price deterioration experienced broadly across U.S. stocks reportedly caused the computerized logic of at least some of the algorhythmic trading programs employed by market makers and liquidity providers to question the value of U.S. stocks generally. *See* "Confirming the Omen of May's Flash Crash", Gordon Long, publicly available at http://www.minyanville.com/businessmarkets/articles/flash-crash-stock-market-economy-stock/6/2/2010/id/28567.

[14] This concept, which BlackRock refers to as "valuation clarity", is, in BlackRock's opinion, one of two essential factors necessary for ETFs to trade effectively. BlackRock has consistently stressed the need for valuation clarity in order for ETFs to trade in line with underlying value in its statements to the Commission and its staff. *See* the iShares ETF Rule Comment Letter, *supra* note 4.

[15] A related concern is that the proposed circuit breaker pilot is not coordinated with other exchange-traded instruments whose value is correlated to securities included in the pilot, such as stock index futures contracts.

As additional stocks are added to the pilot program, ETFs that seek to track benchmarks containing those securities also should be added at the same time. Additionally, while we believe it is appropriate for the pilot program to apply the same circuit breaker triggers to ETFs and underlying stocks initially, we urge the Commission and exchanges to use the pilot program to consider whether a different trigger may be appropriate for ETFs.

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We thank the Commission for providing BlackRock the opportunity to comment on the circuit breaker proposals, and we are eager to assist the Commission in any way we can to ensure that the rule proposals will benefit investors generally and ETF investors particularly. In the event you have any questions about any of BlackRock's views, please feel free to contact the undersigned at (415) 670-2860, Michael Latham at (415) 570-4689, Noel Archard at (415) 670-4815, or Joanne Medero at (415) 670-2620.

Sincerely,

/s/ Ira P. Shapiro

Ira P. Shapiro
Managing Director

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