

JOINT CFTC-SEC ADVISORY COMMITTEE ON EMERGING REGULATORY ISSUES

Minutes of November 5, 2010 Meeting

The Joint CFTC-SEC Advisory Committee on Emerging Regulatory Issues (“Advisory Committee”) convened its third meeting at 9:00 a.m. on Friday, November 5, 2010 in the Hearing Room at the Headquarters of the Commodity Futures Trading Commission, located at Three Lafayette Centre, 1155 21st St., NW, Washington, D.C. The meeting, which was open to the public, was held to provide the Advisory Committee an opportunity to hear the views of panelists representing various investor perspectives regarding the events of May 6, 2010. The agenda for the meeting included: (1) Receipt of a summary and recap from the staffs of the SEC and CFTC on the report issued on September 30, 2010; (2) Report from the subcommittee on cross-market linkages; (3) Report from the subcommittee on pre-trade risk management; and 4) Discussion of potential recommendations and responses. The meeting concluded at 11:57 a.m.

Advisory Committee Members:

CFTC Chairman Gary Gensler, Advisory Committee, Co-Chair; SEC Chairman Mary Schapiro, Advisory Committee Co-Chair; Brooksley Born; Jack Brennan; Robert Engle;** Rick Ketchum; Maureen O’Hara; Susan Phillips; David Ruder; Joseph Stiglitz*

*Present by telephone **Not present

Co-Designated Federal Officers:

James Burns, Counsel to SEC Chairman Schapiro; Timothy Karpoff, Counsel to CFTC Chairman Gensler

CFTC and SEC Commissioners in attendance:

From the CFTC: Commissioner Bart Chilton,* Commissioner Michael Dunn,* Commissioner Scott O’Malia

From the SEC: Commissioner Elisse Walter

*Present by telephone

CFTC and SEC Staff Presenters:

From the CFTC: Andrei Kirilenko, Senior Financial Economist, Office of the Chief Economist;¹ Steve Sherrod, Acting Director of Market Surveillance, Division of Market Oversight

From the SEC: Gregg Berman, Senior Advisor to the Director, Division of Trading and Markets

Other Agency Staff Participants:

From the CFTC: Jim Moser, Acting Chief Economist

From the SEC: Robert Cook, Director, Division of Trading and Markets; David Shillman, Associate Director, Division of Trading and Markets; Dan Gray, Senior Special Counsel, Division of Trading and Markets

¹ Mr. Kirilenko was appointed Chief Economist on December 21, 2010.

I. OPENING REMARKS

Chairman Gensler called the meeting to order at 9:05 a.m. Chairman Schapiro presented opening remarks in which she described certain recent actions of the SEC relevant to the work of the committee including approval of a pilot project by the national exchanges and FINRA to pause trading in a security when its price moves more than ten percent in five minutes, rules providing clarity when clearly erroneous trades are broken, and planned rules regarding the use of stub quotes and market wide circuit breakers. Chairman Gensler presented opening remarks in which he expressed interest in hearing the committee's views on (i) how market integrity should be protected both in light of the May 6 market events and changing technology; (ii) what, if any, additional risk protection should be considered with regard to the use of algorithmic and high-frequency trading; (iii) should exchanges and executing brokers be required to update risk mechanisms including, in particular, rules for market pauses; (iii) the CFTC's recent actions including an advance notice of proposed rulemaking regarding disruptive trading practices.

II. PRESENTATIONS BY CFTC AND SEC STAFF

Andrei Kirilenko of the CFTC and Gregg Berman of the SEC made a presentation summarizing the major themes of a report, *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* (September 30, 2010). Mr. Kirilenko discussed three thematic aspects of the market events of May 6, 2010: (i) overall market uncertainty; (ii) a large sell program event in the E-Mini contract; and (iii) the propagation of volatility to other markets and securities. Mr. Berman discussed how the events of that day related to the equity markets, including (i) linkages between the futures and equity markets; (ii) the finding that equity market liquidity providers and market makers pulled back from participation in the market in response to the May 6, 2010 market volatility resulting in very disorderly prices; (iii) the finding that the market conditions on May 6, in conjunction with the use of automatically generated "stub quotes", resulted in the execution of some trades at absurd prices such as a penny or one-hundredth of a penny; (iv) the impact of high-frequency trading; and (v) the capacity of public market data feeds to keep up with highly volatile conditions.

Steve Sherrod of the CFTC discussed the CFTC's recent proposed rule concerning market manipulation of swaps and advance notice of proposed rulemaking regarding disruptive trading practices.

Committee discussion of the staff presentations addressed issues including the latency time and content of public and proprietary market data feeds, the characteristics and parameters of trading algorithms in relation to avoiding future market disruptions of the sort that occurred on May 6, 2010, and potential measures to reduce the incidence of erroneous trades.

III. REPORTS OF CROSS-MARKET LINKAGES AND PRE-TRADE RISK MANAGEMENT SUBCOMMITTEES

Committee member Ketchum presented a report on the activities of the Pre-Trade Risk Management Subcommittee. He stated that the subcommittee had held several phone

conversations whose purpose was to clarify the subcommittee members' view of the market environment that existed on May 6, 2010 and continues at and to identify issues. He noted that both subcommittees had identified issues that cut across the boundaries of the two subcommittees.

Mr. Ketchum stated that the equity markets were characterized by (i) significant fragmentation with something like 30% of trading occurring outside of organized exchanges but tending to flow back to organized exchanges in times of pressure and volatility; (ii) commodification of markets resulting in pricing constraints on the ability of markets to encourage entities to serve as liquidity providers and market makers; (iii) high levels of high-frequency and electronic trading that sometimes result in levels of message traffic that create delays and inconsistency in the dissemination of market data; (iv) proliferation of algorithmic trading. He stated that these market characteristics create challenges from the standpoint of liquidity problems that can result in very significant market volatility and that because of the speed of trading uncertainty becomes a major factor affecting the behavior of the market. He stated that these developments have also increased the already significant interrelationship among the various US securities and derivatives markets.

Committee member Brennan reported for the Cross-Market Linkages Subcommittee. He stated that this subcommittee focused on (i) investor confidence; (ii) trading halts and pauses and the complications posed for such policies in interrelated markets; (iii) transparency and fair and equal market access including issues relating to collocation; (iv) what responsibilities should come with direct or sponsored access, or other privileged access, to markets; and (v) potential problems of "empty books" or "false liquidity" in markets characterized by high-frequency trading.

The subcommittee presentations were followed by a general discussion of the issues raised by the presenters.

IV. CLOSING DISCUSSION

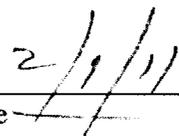
Chairman Gensler requested that committee members inform the agency staffs of their availability for a committee meeting in early January. He asked the members to return with recommendations regarding the May 6, 2010 market events. Minutes of the previous meeting were approved. The meeting was adjourned at 11:57 a.m.

CO-CHAIR CERTIFICATION

I hereby certify the accuracy of this record of the proceedings of the Joint CFTC-SEC Advisory Committee on Emerging Regulatory Issues.



Gary Gensler, CFTC Chairman
Advisory Committee Co-Chair



Date

CO-CHAIR CERTIFICATION

I hereby certify the accuracy of this record of the proceedings of the Joint CFTC-SEC Advisory Committee on Emerging Regulatory Issues.

Mary L. Schapiro
Mary L. Schapiro, SEC Chairman
Advisory Committee Co-Chair

Feb 4, 2011
Date