

COMMENTS FROM  
THE COMMITTEE ON INVESTMENT OF EMPLOYEE BENEFIT ASSETS  
OF THE  
FINANCIAL EXECUTIVES INSTITUTE

ref: File No. SR-NYSE-88-23 and  
File No. SR-NYSE-88-22

These comments present the views of the Committee on the Investment of Employee Benefit Assets (CIEBA), a standing committee of the Financial Executives Institute (FEI), on circuit breakers, or trading halts, in the equity markets.

CIEBA was established as a standing committee of FEI in November, 1985. FEI is an association of 13,000 financial executives representing 6,000 companies in the United States. CIEBA has 40 regular members, who represent a broad cross section of corporate pension funds in the United States in terms of industry group, asset size, and so on. Members of CIEBA collectively manage 300 billion dollars on behalf of more than 6,000,000 union and non-union plan participants. In addition to the 40 regular members, there are also 135 advisory members.

By way of background, the function which our members perform within their respective companies should be briefly defined. Our members' companies sponsor pension, profit sharing, employee savings and employee welfare plans for the purpose of providing retirement income to their employees. Consistent with applicable law and regulation, the companies set aside money for the plans during employees' work lives, prior to the employees retiring and becoming eligible to receive pensions. CIEBA members are charged by their companies to oversee the administration and investment of the pool of assets that accumulates as a result of this funding of future pension benefits and savings.

As pension fund managers, we share two broad objectives: First, to help secure the pension promise made by our companies to plan participants and their beneficiaries. And secondly, to do that in an efficient, cost-effective manner.

CIEBA members have met on numerous occasions since the break in the market to discuss the events of October 1987. While pension funds are typically classified among institutional investors, their perspective on the capital markets is greatly influenced by the fact that pension funds collectively are investing retirement savings for 64 million working and retired individuals. It is obvious that orderly, continuous, liquid markets are necessary to attract individual investors and encourage their participation. But they are also necessary for pension funds who depend on the equities markets to invest new contributions from plan sponsors, to liquidate assets to pay benefits, and to redeploy funds among asset classes and investment managers. Because of our need for stable, well-ordered markets, pension fund sponsors have taken the events of last October seriously, and we have committed ourselves to the national effort to explore ways of preventing a recurrence of those problems.

We believe, however, that overreacting to the events of October by unduly increasing regulation could be risky. First, it could stifle the creativity and innovation which has been the hallmark of the U.S. securities industry and which we believe has yielded major benefits for the economy, the capital markets and our plan participants. Second, it could impair the liquidity and/or continuity of the capital markets which are vital both to the small investor and to us in the discharge of our fiduciary responsibility. And third, undue new regulation could undermine the competitiveness of the U.S. in the world securities industry. This, in turn, could drive certain markets offshore beyond the control of U.S. authorities. For these reasons, we respectfully urge the Commission to proceed gradually and to consider carefully the impact of all proposals. Full and open public debate should continue in order to air all the possible ramifications of prospective change in the regulatory structure of the securities industry. CIEBA is pleased to be part of this continuing process.

CIEBA has given qualified support to the Brady Task Force recommendation concerning use of circuit breakers. The Commission wrote in its report that:

Circuit breaker mechanisms involve trading halts in the various market segments. Examples include price limits, position limits, volume limits, trading halts reflecting order imbalances, trading halts in derivatives associated with conditions in the primary market places, and the like. To be effective, such mechanisms need to be coordinated across the markets for stocks, stock index futures and options. Circuit breakers need to be in place prior to a market crisis, and they need to be part of the economic and contractual landscape. The need for circuit breaker mechanisms reflects the natural limit to intermarket liquidity, the inherently limited capacity of markets to absorb massive, one sided volume. (page 66)

The CIEBA membership finds artificial impediments to free and continuous markets to be generally counterproductive. However, we realize there are natural limits to market liquidity, and that as these limits are approached, as they were on October 19 and 20, free and continuous markets can only be had at the cost of extreme volatility--volatility that may threaten the very foundation of the capital markets and the economy. Thus, the intervention in market processes of circuit breakers of some sort, either man made or spontaneous, seems inevitable.

Having accepted this inevitability, the challenge, as we see it, is for the technical experts in these matters to seek creative approaches to clearing imbalanced markets while providing for as much trading continuity as possible. We prefer mechanisms that would operate without trading halts. Trading halts should only come into play in truly extreme circumstances and should last only as long as absolutely necessary. Otherwise, they should remain unobtrusive. Further, they should be designed to prevent participants in one market from profiting at the expense of participants in other markets when the circuit breakers are in effect. Therefore, they should operate across all U.S. markets for stocks, futures, and options, and their application should be well coordinated.

With regard to the proposals set forth in File Nos. SR-NYSE-88-22 and SR-NYSE-88-23, we wholeheartedly applaud the coordination of effort between the New York Stock Exchange and the Chicago Mercantile Exchange. We support the testing and evaluation of proposals that, in their view, will address the

problems of investor confidence and perhaps ameliorate the current uncertainty surrounding the capital markets.

A consensus was not reached among our members as to the probable effectiveness of these particular proposals, although, again, we support their testing and evaluation. Many of our members feel that the triggers and actions proposed are appropriate and meet the criteria set forth above. However, some others believe that circuit breakers are needed, but believe that the determination to close markets should be made when the markets have stopped functioning in a fair and orderly manner, rather than when a specific pre-set price limit has been reached. Another view is that if pre-set price limits are to be employed, the triggering price changes should be smaller than the 250 and 400 Dow Jones Industrial Average point (30 and 50 S&P 500 point) levels proposed.

Our one specific concern with the joint proposals has to do with the actions triggered at the twelve-point drop in the S&P 500 Stock Price Index futures contract; i.e., the trading limit on the CME and the re-routing of program trade orders on the NYSE. In our view, it appears to be possible that such actions might exacerbate any decoupling of the futures market and the cash market, since the cash market could continue to decline while the futures contract could only trade at or above the current price. If the cash market did continue to decline, then the futures contract would become overvalued relative to the cash market, and with few or no buyers at the overvalued prices, trading in the future would effectively stop. Participants in the futures market would then be effectively locked in, while participants in the cash market could continue to have orders executed. It is our opinion, as mentioned above, that participants in one market should not be advantaged relative to participants in other markets when circuit breakers have been activated. The same decoupling, with its disadvantages, is very likely to occur at both of the other circuit breaker levels, in that trading in the future is likely to be effectively halted before the Dow Jones Industrial Average, as reported, will have fallen sufficiently to halt trading on the NYSE.

Finally, we continue to urge that the market mechanisms be enhanced to make them better equipped to function smoothly under as many different circumstances as possible. The exchanges have already made significant progress in this area, and we applaud those efforts. Our hope is that, over time, arbitrary trading halts will no longer be necessary to ensure the fair and orderly functioning of the markets.

