U.S. Equity Market Resiliency During Times of Extreme Volatility

From global shocks like Coronavirus and oil price fluctuations, market participants must always be prepared for unanticipated volatility. There is a comprehensive range of actions, rules and market mechanisms that aim to prevent extreme price dislocations and temper extraordinary volatility. These important innovations aim to deliver tangible benefits to market participants, liquidity providers and global investors. The following are a few of the most significant protections in place.

Market-Wide Circuit Breakers FAQ

Market-Wide Circuit Breakers

Market-wide circuit breakers are important, automatic mechanisms invoked if markets experience extreme broad-based declines. They are designed to slow the effects of extreme price movement through coordinated trading halts across securities markets when severe price declines reach levels that may exhaust market liquidity.

Market-wide circuit breakers may result in a temporary trading halt, or under extreme circumstances, close the markets before the normal close of the trading session.

- They provide for trading halts in all equities and options markets during a severe market decline as measured by a single-day decline in the S&P 500 Index.

- A market-wide trading halt can be triggered if the S&P 500 Index declines in price as compared to the prior day’s closing price of that index. The triggers have been set by the markets at three circuit breaker thresholds—7% (Level 1), 13% (Level 2), and 20% (Level 3).

- A market decline that triggers a Level 1 or Level 2 circuit breaker after 9:30 a.m. ET and before 3:25 p.m. ET will halt market-wide trading for 15 minutes, while a similar market decline at or after 3:25 p.m. ET will not halt market-wide trading.
• A market decline that triggers a Level 3 circuit breaker, at any time during the trading day, will halt market-wide trading for the remainder of the trading day.

Limit Up-Limit Down

Limit Up-Limit Down (LULD) is a mechanism designed to mitigate extraordinary market volatility and extreme price movements in individual securities. LULD prevents trades in individual securities from occurring outside specific price bands that update continuously throughout the trading day.

The price bands for each security are set at a percentage level above and below a reference price (generally the average trade price over the immediately preceding five-minute period).

How LULD works

• Every security has an upper and lower price band with the reference price as the mid-point. If an offer reaches the lower price band or a bid reaches the upper price band that stock will enter a limit state (a pause) for 15 seconds.

• That security can exit that Limit State if, within 15 seconds, all quotations at the band are executed or canceled in their entirety.

• If the market does not exit a Limit State within 15 seconds, the Primary Listing Exchange declares a five-minute Trading Pause, which halts trading on all exchanges and off-exchange trading venues where that security is traded.

• If the Primary Listing Exchange is unable to re-open under its auction rules at the end of five minutes (e.g., market order imbalance remaining or pair-off is outside its auction collar bands), the Trading Pause is extended in five minute segments until the Primary Listing Exchange is able to open with a trade or quotation.

• Trading will not resume without price bands.

Primary Listing Exchanges that run electronic re-opening auctions have amended their automated auction trading rules to provide for harmonized procedures for extending the Trading Pause and a concurrent widening of their auction price collars every five minutes.

Trading Collars

Trading collars are parameters that prevent trades from executing outside of a designated price range. Exchanges apply trading collars to a range of potential executions, including both auctions and market orders received during the continuous trading day.

Limit Order Price Checks reject limit orders that are priced too far away from the prevailing price of the security.

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Contingency Closing Auction

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Following a market disruption or trading halt on a primary listing market, all U.S listing exchanges have worked together to develop a contingency closing auction procedure to govern an alternate method of establishing an official closing price. For example, in the event that a disruption prevents Nasdaq from conducting a closing auction, pursuant to such rules, Nasdaq could designate NYSE Arca to perform that function, and vice versa.

**Shortened settlement cycle from T+3 to T+2**

As part of an industry-wide initiative, the NYSE shortened its settlement cycle by one day, with the aim to reduce certain risks in the clearance and settlement process, including credit, market, and liquidity risks for central counterparties, their members, and other market participants.

In implementing this change, the NYSE further simplified its rules and eliminated acceptance of any non-regular way settlement instructions.