ADVANCED TRADING

Is The SEC's Circuit Breaker Inviting Rogue Traders?

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The test run of a market-wide circuit breaker instituted last month by the U.S. Securities and Exchange Commission has been well-received across Wall Street, but could it open a Pandora's Box of rogue behavior as currently constructed?

Last week, Citigroup's shares became the second stock to activate the new circuit breaker after an errant trade sent the banking giant's stock plummeting 17 percent. Trading ground to a halt following a trade of 8,820 Citigroup shares that went through at $3.3174, down 12.7 percent from the previous trade and off some 17 percent from the prior day's closing price.

The incorrect trade was later cancelled since the circuit breaker functioned as designed. But a system that allows a single erroneous trade to be enough to halt the trading of a stock like Citigroup, which changes hands hundreds of millions of times a day, is one that's ripe for abuse, according to **Joe Saluzzi**, the co-founder of the institutional brokerage firm **Themis Trading**.

"Every trader in the world who has the ability to print a trade on an exchange or trade reporting facility now has the power to halt a stock at any given time," **Saluzzi** contends. "There seems to us to be a high probability of an abuse of power here. If the circuit breakers get extended to all stocks, you can expect to hear the popping of breakers more frequently than popcorn popping in a microwave."

Saluzzi argues that the SEC should limit potential abuses by only allowing the circuit breaker to go off in the event of a minimum number of erroneous trades. Under the guidelines of the circuit breaker pilot program, any stock within the S&P 500 moving up or down 10 percent or more within a 5-minute timeframe is brought to a standstill.

"Let's say I was a prop shop and I didn't like the way a stock was trading and I wanted to halt the stock. You could just put up 200 shares and put it at 10 percent away and the stock is going to halt," **Saluzzi** says. "How insane is that? If people weren't thinking of it, you can bet those bad guys are saying wow. We can halt this stock. And then when the SEC comes to them and asks what happened … they're going to turn around and say, 'fat finger, sorry.'"

The pilot is scheduled to last through Dec. 10, and so far the SEC appears wise to have implemented it on a trial basis as it sorts out the flaws in the nation's electronic marketplace. For regulators are still at a loss as to what exactly caused the May 6 market crash when the Dow Jones industrial Average took a 1,000 point nosedive in less than a half-hour, its largest intraday plunge ever.

Saluzzi raises a good point about potential abuse of the circuit breaker, but one could argue that the pilot has been successful already by highlighting flaws in the market's structure. And in the coming months, market experts will be able to pinpoint the limitations of the pilot before regulators craft a final solution.

Three weeks ago, shares of The Washington Post Co. were halted when three errant equity orders pushed the stock to more than twice its value in less than five minutes. The shares had been trading at $455 each. Two of the trades went through the electronic platform NYSE Arca for $919.18 a share, and the third was for $929.18.

"Why should a trade like that even be allowed," says **Saluzzi**, suggesting that for-profit exchanges have become more concerned about boosting revenue and the level of market data they process and less concerned about the quality of the market. "We have to take a serious look at our exchanges and how they operate and whether a for-profit model still is the right model to go off of."