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Before the

House Financial Services Subcommittee on Capital Markets and

Government Sponsored Enterprises

Market Structure: Ensuring Orderly, Efficient, Innovative and

Competitive Markets for Issuers and Investors

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Chairman Garrett, Ranking Member Waters, and members of the Subcommittee:

I. Introduction

My name is Daniel Coleman and I am the Chief Executive Officer of GETCO, a leading global electronic market maker. I appreciate the opportunity to provide testimony regarding equity market structure.

The regular review of our capital markets, and the regulatory framework that applies to it, is critical to the continuing vibrancy of those markets. This review is more vital now than ever before because, over the last decade, investor confidence in our markets has slowly deteriorated, as nearly every facet of our financial and banking systems have in one way or another led investors to question the effectiveness, transparency, stability, fairness and overall legitimacy of how our markets manage risk, promote capital formation, allocate capital and operate fairly.

It started with the bursting of the Internet technology bubble in 2000, followed by accounting and investment banking scandals in 2001 and 2002, the mutual fund late trading and market timing disgraces of 2004, and culminated in the events of the last four years: (1) the credit bubble that initiated the 2008 financial crisis that nearly destroyed our financial and banking system; (2) the heart stopping May 6th 2010 "flash crash" that caused investors to doubt the operational stability of our national market system, and; (3) the recent events of this year that raise legitimate concerns about the role of technology in the capital formation process.

And, while critics of our current market structure pinpoint the lack of investor confidence solely on the shortcomings of our national market system, the last decade has also brought transformational and positive changes in how capital is allocated and investors access liquidity. These changes reflect why the U.S. markets are still the most dynamic, efficient and trusted markets in the world.

GETCO has witnessed first-hand these positive developments and we believe that if certain regulatory and operational changes to our current market structure are adopted that adhere to core principles—promoting competition, price discovery, efficiency, transparency, stability and fairness—investors will once again believe in the soundness of our financial, banking, and capital market systems and trust the financial community with their hard earned investing dollars. We look forward to participating and contributing to this discussion.

II. Background on GETCO

GETCO was founded in 1999 by two Chicago floor traders from the Chicago Board Options Exchange and the Chicago Mercantile Exchange who saw that their business of market making or "risk transfer" was at the beginning of a transformational shift from analog to digital—or in trading parlance from the "pit" to the "screen." This transformation has occurred in nearly all asset classes and products—from stocks, like GM and GE that are listed on the New York Stock Exchange, to futures contracts tied to agricultural products, like corn and soybeans that trade on the CME. As a result, in the last 13 years GETCO has grown to trade on over 50 exchanges and trading venues around the world in cash and futures products across four asset classes – equities, fixed income, currencies and commodities. The firm currently has over 400 Associates located in Chicago, New York, Palo Alto, London, Singapore and Hong Kong.

GETCO's primary business is as an electronic market maker—which is akin to a floor trader or "specialist" of the last century—posting two-sided markets on exchanges around the world to help investors efficiently transfer the risk associated with holding a particular asset. The service GETCO provides allows investors to immediately access publicly available liquidity, while saving money on trading costs. In the U.S., GETCO is a registered market maker in over 4000 securities on various equity and options exchanges[1] and is the second largest Designated Market Maker on the New York Stock Exchange.

In 2008, GETCO expanded its core market making business by establishing GETCO Execution Services ("GES")—a client services business that executes orders on behalf of other broker-dealers and institutional clients. Through GES, GETCO operates three distinct businesses that leverage the technology and expertise of a global market maker. These services—GETMatched, GETAlpha and GETRouted— are designed to meet new demands by clients for better execution, routing and algorithmic services. In 2010, we began expanding these offerings to European markets.

GETCO's Role as a Market Maker

Market makers such as GETCO have existed for hundreds of years and their role has stayed constant: to bridge the gap in time between when natural buyers and sellers enter the market. GETCO fundamentally believes that one of the primary purposes of a financial market is to allocate risk to those persons or entities best able to bear it. As natural counterparties do not necessarily meet in time, place, and size, market makers such as GETCO commit their own capital and assume a variety of financial risks until a natural counterparty can be found.

In performing this intermediation role, market makers do not take directional positions or make "bets" on the long term price of an asset. Instead, by providing continuous two-sided quotations, market makers allow consumers of liquidity (i.e., natural buyers and sellers) to immediately trade

1 Registered Equity Market Maker: BATS; Direct Liquidity Provider: Nasdaq; Lead Market Maker: NYSE Arca, Designated Market Maker and Supplemental Liquidity Provider: NYSE; and Registered Option Market Maker: BATS Options, C2, Chicago Board Options Exchange, International Securities Exchanges, Nasdaq Options Market, NYSE Amex Options, and NYSE Arca Options.

Market Makers Provide Multiple Benefits to the Markets:

- **Lower trading costs** by reducing the costs associated with finding someone with whom to trade.
- **Reduce market volatility** by buying when others want to sell and selling when others want to buy.
- **Add liquidity and facilitate price discovery** by posting quotations against which other market participants can use to value their portfolios or trade.
- **Promote competition** among market centers and liquidity providers so that individual and institutional investors benefit from lower costs and access to diverse liquidity pools.

In exchange for these services, market makers generate revenue from the “Bid/Ask” spread, the difference between the buying price and selling price of a security. Numerous studies show that this spread has dramatically fallen over the last 20 years. This narrower spread is a direct cost savings to investors.

Automation is used by today’s electronic market makers to manage their risks by controlling how and when orders are placed and modified. By using technology to better control their risks, market makers can offer better prices and reduce trading costs to investors. Electronic market makers provide the same benefits to market participants as traditional market makers but on a greater scale:

- Dampen market volatility
- Reduce trading costs
- Provide liquidity
- Facilitate price discovery
- Provide safe and efficient method of risk transfer

GETCO's Client Services Business

GETCO's client services business offers three high-tech trading solutions that help investors solve their execution needs:

- **GETAlpha:** An execution algorithm for U.S. equities that uses the same high-tech trading tools as a dedicated electronic market maker. By leveraging GETCO's proprietary trading systems and expertise, GETAlpha allows institutional investors to place trades with minimal market impact and protects against information leakage or detection.

- **GETRouted:** A smart order routing solution for U.S. equities that provides institutional investors with the ability to completely customize their order execution strategy.

- **GETMatched:** An Alternative Trading System registered with the SEC that provides access to the dedicated liquidity of GETCO's electronic market maker. GETMatched is the 5th largest OTC platform or "dark pool" by volume and executes trades only when there is a match at the National Best Bid and Offer (NBBO) or better.

All client offerings are fully optimized for interaction with each other.

III. U.S. Equity Market Structure

Over the last 15 years, technology advancements and regulatory changes have created a U.S. equity market that is open, efficient, stable, transparent, competitive, and innovative. From the standpoint of choice, access, and cost, investors are better off than ever before in today's markets. Execution speeds have improved, trading costs are lower, and liquidity has increased, as measured by tighter bid-ask spreads and larger size in the consolidated market order book. And despite such dramatic improvements in how our markets function, investor confidence is as broken as it has ever been. It has been shaken by a series of high-profile events that paint a picture of an overly complex, fundamentally fragile market-system. In spite of many advances, investors—both individual and institutional-- feel out-gunned, over-whelmed and out-of-touch.

A. Post-May 6th Reforms

The market events of May 6, 2010 revealed flaws in the U.S. equity market structure. GETCO is very supportive of the SEC's and CFTC's well-reasoned reforms since then, which limit the potential for another, similar event. Within the first few months, the SEC led the exchanges and FINRA in implementing single stock circuit breakers, eliminating stub quotes, and establishing clearer rules for breaking trades that are clearly erroneous. This quick action went a long way to restoring confidence in the markets.

In addition, the SEC and CFTC established a Joint Advisory Committee on Emerging Regulatory Issues composed of industry leaders and investor representatives. This Committee made well-reasoned recommendations for further regulatory reforms,[2] some of which the SEC has already adopted.

For example, a few weeks ago, the SEC approved the securities exchanges' and FINRA's Volatility Plan (the "Plan")-- a market-wide limit up-limit down mechanism to address extraordinary market volatility. GETCO supported this new Plan, which is intended to replace the single-stock circuit breaker pilot that was put in place beginning in June 2010. This new Plan improves upon the single-stock circuit breaker pilot by preventing trades in NMS stocks at prices outside of appropriate pre-set limits. The Plan also retains the concept of trading pauses when more fundamental price moves occur.

In addition, in November 2011, the SEC adopted a ban on naked sponsored access and required broker-dealers that provide access to trading on an exchange or alternative trading system to implement prudent risk management controls. GETCO supports these requirements[3] and many other jurisdictions have, or are considering, similar measures. In its market making business, GETCO trades its own capital so risk management is an essential component of our operations. Accordingly, GETCO supported the market access rules because any market participant with the

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[2] Recommendations Regarding Regulatory Responses to the Market Events of May 6, 2010, Summary Report of the Joint CFTC-SEC Advisory Committee on Emerging Regulatory Issues (February 18, 2011).

[3] Letter to Elizabeth Murphy, Secretary, SEC from John McCarthy, General Counsel, GETCO, dated April 1, 2010 (commenting on the SEC's proposed Risk Management Controls for Brokers or Dealers with Market Access).

ability to directly enter orders onto a market should be subject to the same pre-trade risk management and supervisory procedures as registered broker-dealers.

Finally, GETCO supports the creation of a Consolidated Audit Trail[4] to provide the SEC and the SROs with efficient access to a robust and effective cross-market order and execution tracking system. We do not, however, believe that a "real time" audit trail is necessary to achieve this objective and would impose significant costs on both regulators and the industry. Instead, audit trail information received on a delayed basis would provide the same benefits as real-time information, at a substantially lesser cost.

B. Roles, Obligations and Incentives for Market Makers

Despite the worldwide financial turmoil of the last several years, U.S. markets are still the most liquid and efficient in the world. GETCO believes strongly that a significant reason for the high quality of U.S. markets is the liquidity provided by market makers.

While all market participants contribute to efficient and liquid markets, a market maker's primary activity is to facilitate trades by buyers and sellers either on an exchange or in the OTC markets. Market makers come in different shapes and sizes, but they perform many similar functions. In general, a core principle of market making is the immediate provision of liquidity to buyers and sellers – either directly to a market maker's customers or indirectly through the public markets. Market makers create a steady and continuous stream of liquidity – buying when investors and other market participants are selling and selling when they are buying. By providing liquidity on a continuous basis, market makers facilitate the efficient transfer of risk.

In response to the events of May 6, 2010, the SEC-CFTC Joint Advisory Committee on Emerging Regulatory Issues recommended that the SEC evaluate whether incentives or regulations can be developed to encourage persons who engage in market making strategies to regularly provide buy and sell quotations that are "reasonably related to the market."

GETCO supports this recommendation and believes that fair questions have been raised about current market rules that impose no real quoting or trading requirements on market makers, nor

4 Letter to Elizabeth Murphy, Secretary, SEC from John McCarthy, General Counsel, GETCO, dated August 10, 2010 (commenting on the SEC's proposed Consolidated Audit Trail).

provide adequate incentives. As articulated in our letter, to the SEC staff in July of 2010,[5] we, along with Virtu Financial and Knight Securities, believe the obligations associated with market making need to be modernized to reflect the current electronic markets that evolved over the last 10 years. By encouraging market participants to undertake clear and meaningful obligations, we believe the likelihood of instances of price dislocations like the one that occurred on May 6th 2010 would be substantially reduced.

C. Undisplayed Liquidity

As the SEC noted in its Concept Release on Equity Market Structure,[6] undisplayed liquidity is not a new phenomenon. Dark liquidity in the equity markets takes the form of undisplayed orders carried by floor brokers and block orders held upstairs, as well as over-the-counter market makers that trade with retail customer orders. These non-displayed pools of liquidity are beneficial and serve numerous legitimate functions, including improving fill prices, reducing market impact and information leakage, lowering transaction fees, and fostering innovation.

The impact of undisplayed liquidity on the quality of public price discovery is an area of inquiry by policymakers in many jurisdictions around the world. Publicly disseminated prices serve an important role in price discovery and the challenge for regulators is to strike the right balance in protecting the important role that public markets play in fostering price discovery, while also recognizing the interests served by undisplayed pools of liquidity. This inquiry requires policymakers to balance the public good that is associated with encouraging market participants to publicly display orders with the interests of each individual retail and institutional customer to get the best execution for its order.

GETCO believes that there are incremental market-based changes that the SEC could make that would promote price discovery, without reducing the choices that investors have regarding where to trade and preserving the ability of new market centers to innovate, develop, and compete. As discussed in more detail below, GETCO believes that the SEC could adjust tick sizes for certain high and low priced securities, treat actionable indications of interest (IOIs) as

[5] Letter to Robert Cook, Director, Division of Trading and Markets, SEC dated July 9, 2010 from John A. McCarthy, General Counsel, GETCO, LLC, Christopher R. Concannon, Partner, Virtu Financial, LLC, and Leonard J. Amoruso, General Counsel, Knight Capital Group, Inc.

[6] Securities Exchange Act Release No. 61358 (Jan. 14, 2010), 75 FR 3594 (Jan. 21, 2010).

quotations, and lower the threshold for requiring display into the public quote stream of IOIs and other quotations.

1. Tick Sizes

GETCO believes that there are optimal tick sizes for securities, which are not always the same as the narrowest tick size. Optimal tick size is important to fostering price discovery in the public market and promoting efficient markets. The optimal tick size depends on the liquidity of a stock, its price and volatility.

SEC rules currently establish minimum tick sizes at 1 cent for securities priced above $1.00. This current minimum tick size requirement creates inefficiencies and has detrimentally affected the price discovery process. As stock prices decline, the tick size becomes a greater percentage of the price of the stock - incenting internalization and hidden liquidity in certain low priced securities. By contrast, in Europe, in the absence of regulation around tick size, the exchanges mutually agreed on a tick size for a range of prices. As the stock price decreases, so does the tick size.[7] GETCO believes that all orders in the U.S., especially retail orders, would routinely receive better-priced executions if the minimum tick size were correlated to the share price of the security.

An example of this can be seen in Citigroup, which - until its reverse split - was a low priced, but highly liquid stock. A firm's profit from trading against its client orders in Citigroup - a $5 stock with a 1 cent / 20 basis point spread - was significantly higher than the profit made from internalizing a client's order in Microsoft - a $30 stock with a 1 cent / 3 basis point spread. As a result of an inappropriately large tick size, the Citigroup orders – as with other low priced, high volume securities - were less likely to be traded on the public transparent markets.

[7] To illustrate, in the U.S., all stocks under $10.00 have a tick size that is greater than 0.1% of the stock price. By contrast, in Europe, the tick size is never more than 0.1% of the stock price. Also, in the U.S., all stocks above $50.00 have a tick size that is less than 0.02% of the price. In Europe, by contrast, the tick size of a stock is never less than 0.02% of the price.

2. Actionable Indications of Interest

GETCO supports transparency and its role in the public price discovery process. We support the SEC's proposal to treat actionable IOIs as quotations, subject to the same obligations as explicit firm quotes under SEC rules. Actionable IOIs convey information that there is actionable trading interest in a security, which is the same as the information conveyed by a firm "bid" or "offer."

GETCO's alternative trading system, GETMatched, does not display orders to any users of the trading system. Moreover, GETMatched does not interact with IOIs from other trading venues. We believe that when participants in exchanges or ATSs have access to information about potential trades that other market participants do not have, it creates a two-tiered market that is inconsistent with an efficient market structure.

3. Lowering the Threshold for Order Display and Execution Access

GETCO supports the SEC's proposal to lower the threshold at which ATSs must display the best priced orders in the public quotation stream. Currently, if an ATS displays orders to more than one person, its best-priced orders must be publicly disseminated when the ATS accounts for 5% or more of the average daily volume for a stock. The ATS must also provide broker-dealers the ability to trade with the displayed order. The SEC proposed to lower the threshold to 0.25% from 5%. GETCO agrees with the Commission that lowering this threshold would reduce the potential for a two-tiered market and improve the quality of publicly available quotation data.

D. Liquidity Rebates

Markets have always rewarded or incentivized market participants to provide liquidity. The practice by some trading venues of offering rebates to participants that provide passive liquidity leveled the playing field by opening up liquidity provision to competition. Rebates allow market makers to post better prices on *public markets*, which directly improve the executions of liquidity takers. In the absence of rebates, effective spreads would be wider, and wider spreads are a cost borne by liquidity demanders in the same way as explicit fees.

Rebates allow market makers on public trading venues to post competitive prices, with the result of reducing transaction costs and increasing liquidity. Because of the ability of liquidity providers to post better quotes, average investors, whose orders are frequently internalized at the prices displayed in the public market, also have lower transaction costs as a result of these rebates.

The rebates paid to liquidity providers are generally funded through explicit fees paid by liquidity takers. However, when this explicit fee is paid by investors to trade with a better priced quote, the investor receives a better net execution price. A liquidity taker that trades on a market with the best quoted price and transparent "taker" fees that are less than the minimum trading increment will always be receiving the best net price. For this reason, it is important that policymakers consider all costs – implicit and explicit – in comparing the costs to liquidity demanders associated with maker-taker models and other pricing models.

GETCO does not employ unique trading strategies that are designed solely to earn a rebate. The firm is a market maker on exchanges that offer a rebate for posting passive liquidity and we are market makers on exchanges that do not – such as the NYSE. Rebates, when offered, are incorporated into determining the price at which we are able to quote a security. On markets on which we earn a rebate, we are able to post much tighter markets. GETCO makes markets on trading venues that employ the maker-taker pricing model, as well as on those that do not.

Nevertheless, rebates can create a conflict for brokers responsible for making routing decisions for their customers. This is particularly the case when trading venues offer rebates to brokers for *taking* liquidity. These rebates are akin to payment for order flow and broker preferencing arrangements that have long existed in the equity markets. It is important that regulators examine all these conflicts in determining how to best ensure that customers' interests are placed above their brokers.

Finally, the controversy regarding rebates offered by trading venues indicates that institutional investors are not confident about where or how their order is being executed. The SEC has historically championed the rights of the retail investor, but generally felt institutional investors were sophisticated enough to manage on their own. In fact, there is a growing digital divide even amongst professional participants.

To help institutional investors navigate this divide, there needs to be greater clarity around order execution quality for professional participants. Furthermore, institutional investors need to understand the trade-offs and financial incentives involved in routing decisions by their brokers.

Additional transparency and better order execution analysis would help to alleviate concerns around gaming, manipulation and information leakage; and return a level of control and confidence to institutional participants.

E. Co-Location and Data Feeds

Today's professional traders use co-location and proprietary data feeds offered by market centers. The securities laws require exchanges to provide fair access to these tools to all market participants and represent market responses allowed by advances in communications and broadband technology.

1. Co-Location

Co-location is the modern day trading floor. Co-location is where a trading platform offers space in its data center for members to locate their own computer hardware to reduce the time it takes to receive information and place orders on the market.

Historically, market makers and other professional market participants have wanted to be as close as possible to the center of price discovery. Market makers need to manage the risk associated with making markets and speed; certainty of execution and proximity allow better risk management. Before the advent of electronic trading, this meant buying a "seat" or membership on an exchange. Exchange floors have now largely been replaced with computer "matching engines" and today's market makers need to be as close to the center of price discovery in the exchange's matching engine as possible.

We believe that co-location is a positive development because it equalizes access for participants who wish to be near the center of price discovery. Any market participant that determines that speed is an essential component to its trading strategy or risk management can invest in co-location. Most brokers are either co-located themselves or access markets through member firms that are co-located.

2. Data Feeds

As the SEC noted in its Equity Market Concept Release, the information in individual market center data feeds generally reaches market participants faster than the same information in the consolidated data feeds. The slower speed of the consolidated data feed is attributable in large part to the extra step required for data to be consolidated and redistributed. As a market maker, GETCO subscribes to data feeds directly from the exchanges. Having the most up-to-date information on market prices allows GETCO to better manage its risks, which in turn allows the firm to post better priced quotations.

GETCO also notes that, if proprietary data feeds were prohibited or delayed, large market participants would have an informational advantage over small participants. Large participants would have immediate access to their own trading activity, while other market participants would have to wait until they received the consolidated data feed or delayed exchange data feed.

IV. Dodd-Frank Act, Title VII

The Financial Crisis of 2008 prompted widespread realization among regulators, legislators and the general public that the derivatives markets were opaque, lightly regulated and ultimately backstopped by individual taxpayers when governments were forced to concede that certain institutions were simply “too big to fail.” The Dodd-Frank Act attempts to address these issues by:

- limiting the risk government-backed institutions can take making proprietary trades;
- increasing transparency around derivative exposure through the mandated clearing of standardized products; and
- facilitating the entrance of new participants to create a more competitive, diverse market place.

Clearing in the swaps market is the critical first step in this process. There’s little disagreement about the systemic benefits of clearing the most standardized and liquid swaps. By substituting the clearing house as the counterparty in a swaps transaction, it reduces counterparty credit risk by mutualizing exposure. A clearing house also provides an objective and robust process for monitoring and managing risk and requires clearing members to contribute margin or collateral to insure that the clearing house can withstand the default of members.

In addition to these direct risk mitigation benefits that clearing houses provide, a cleared swaps market has the potential to allow a much wider array of participants to provide liquidity. Non-bank liquidity providers, such as GETCO, who do not enjoy a federal guarantee, are ready, willing and able to provide liquidity in the swaps market as soon as central clearing is established. For this reason, broad access to clearing houses – together with robust measures to ensure the safety and soundness of clearing houses – is critical to achieving the goal of reducing systemic risk.

The ability of a greater diversity of market participants to act as dealers in a cleared swaps market, would reduce the systemic risk we face today with a few "too big to fail" banks as the sole counterparties in these swaps markets. This diversification is precisely what was intended when the laws were envisioned and will ultimately increase the overall integrity and resiliency of the swaps markets by decreasing the risk of systemic failure.

Thank you.