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U.S. House Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises

May 18, 2004

I commend the Chairman and the Members of the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises for holding these hearings on the SEC's proposed changes to U.S. Equity Market structure. We are at a crossroads in the history of our markets, and much depends on the decisions we now make. The two overarching issues addressed in the SEC's RegNMS proposal- trade through relief and market data reform- are of crucial importance to the American investor. We have an historic opportunity to create fairer, more competitive markets that ensure that America's role as the financial center of the world continues well into the future.

The world of U.S. Equity trading has been split into two camps for decades. In one camp, the NYSE-Listed world, human and manual driven processes rule. This camp has evolved over time to suit the humans that drive it. The rules, regulations, and trading strategies in this world have all been shaped over time to ensure the primacy of the upstairs Listed trading professionals and the Floor community. In the other camp, the OTC world, electronic immediacy has become the standard for price discovery. The rules, regulations, and trading strategies in this world have evolved over time to favor electronic markets and their users.

Technology has widened the chasm between these two disparate market structures. Technology drove the overhaul of the OTC market after the SEC's sweeping Order Handling Rules in 1997. Seven years later, virtually every OTC quote in the market is a firm indication to trade, and is readily available for auto-execution. This contrasts sharply with the NYSE, where Specialists are given the opportunity to interact selectively with orders in exchange for agreeing to keep an orderly market.

Interestingly, while technology was responsible for further widening the chasm between the OTC and Listed worlds, it is now the primary factor pushing them together again. New technologies like Lava Trading Floor have made it possible to interact with both marketplaces through a common interface. This has led most big Wall Street trading desks to ditch the old model of separate OTC and Listed trading desks that rarely interacted. Now, the desks are "sectorized," meaning that the desks are divided up by stock industry sector (a much more rational result). This change has illuminated the stark differences in speed and certainty between the Listed and OTC markets. Because the trader trading DELL on Nasdaq is for the first time the same trader trading HPQ on the NYSE, there is a bridging of the two trading worlds.

The OTC and Listed Sell-Side broker business have been further mixed with the rise in Program Trading. Program Trading has enabled Asset Managers to execute lists of many stock orders all at once, which makes better risk management and execution quality management possible. The lists of stocks to be executed by a Program Trading desk are inevitably mixtures of both OTC and Listed stock names. Because of this phenomenon, the same execution pathway is being used for the first time for both OTC and Listed executions.

Technology has also enabled the explosion of a new industry: electronic modeling. Electronic modelers employ sophisticated techniques to run limit-order intensive strategies in the market. These players place millions of liquidity enhancing orders a day into the market. Examples of common strategies include Statistical Arbitrage and Index Arbitrage. Modelers now provide a very significant percentage of liquidity in the marketplace, leading electronic marketplace to compete aggressively for their business. This has given them great power over the features and benefits of the electronic marketplaces.

Technology has also made it easier to deliver new electronic trading services. Electronic Communications Networks arose in 1997 after the SEC's Order Handling rules. These new entrants into the OTC market remade the market entirely. Whereas before their arrival the OTC market was infamous for wide spreads, non-firm quotes, and gaming, today the OTC market has the tightest spreads, virtually only firm quotes (only the recent scattered quoting by the traditional American Stock Exchange is an exception), and pathological competition. The ECN's were remade into Alternative Trading Systems (ATS's) with RegATS in 1998. The ATS's remade the OTC marketplace, but did not make significant forays into the Listed marketplace until 2000 and 2001.

The first real success enjoyed by an electronic market in the Listed environment was by my old company, Island ECN, in the ETF's. There were several factors that made this success in the ETF's easier than succeeding in the NYSE-Listed world. One, ETF's are derivatively prices instruments. They are therefore less dependent on the central price discovery process of any one market. Instead, they are priced off of the values of their underlying stocks and the price of the futures instruments that track the same indices. Two, because of the nature of these derivatively prices instruments, price changes are often more rapid than in most individual stocks. This puts a premium on speed, reliability, and certainty of execution- metrics that are in the power alley of a top ATS. Third, the customers who make the best use of ETF's were already heavy users of ATS's, and were predisposed to understand and make use of the particular benefits that ATS's provide.

As the ECN's, in particular Island, quickly grew to dominate the American Stock Exchange and the NYSE in ETF trading, the SEC correctly realized that the two disparate trading worlds could no longer exists in separate orbits. The traditional human driven Listed markets and the electronically driven OTC markets were in the midst of the first true battle in a very long war for the control of the future of U.S. equity trading.

Wisely, the SEC has moved in recent months to address the disparities between the markets. For instance, their recent short sale proposal addressed the differences in short sale treatment between the two markets. Now, we have the RegNMS proposal. Among may things, it seeks to address two key inefficiencies in the marketplace: Trade-through and Market Data.

The Trade-through rule prohibits an Exchange from consummating a trade in a Listed security at a price inferior to one displayed on another Exchange. While this might appear sensible on first blush, the rule does not address a central tenet of market economics: There is not one sole criterion for value. Advertised price does not, for instance equate with true price. Suppose you have the choice between two identical Ford Mustangs. Both are brand new, both have identical features. But one is selling for $20,000, and the other is selling for $19,000. Which one would you want? The only correct answer in my book is "I don't have enough information to make that decision."

Why? Because there are other factors that affect not the *advertised* price of the car, but rather the *true* price. Suppose the $19,000 car was in California, but the $20,000 one was right here in Washington, DC. It might very well cost more than $1,000 to ship the car from California to where you could actually use it, so when the *true* prices of the cars are tallied, the one with the lower *advertised* price is actually more expensive! This simplistic example could only understate the degree of variance in the stock market between true and advertised price. Factors such as time, certainty of execution, implicit fees, adverse selection, and reliability make advertised prices only a small part of the execution story.

It is the job of every trader and every broker to make the tough calculations of value necessary to get the investor the best *true* price. It should not be the job of an Exchange or ATS to do that job for them. The ATS's and Exchanges are very good at creating the best possible destinations for orders through innovation and competition. The traders and brokers in this country are as a group highly adept and figuring out what the real best price is for a customer. Mixing these roles stifles competition and innovation, slowing the marketplace down the lowest common denominator. Trade-through, I have often said, is equivalent to sending a dozen people off to climb a tall mountain, but first tying them together with a rope. If one falls, they all fall. If one feels like sitting down and making the rest carry him to the top, he can. This is not a solution worthy of our markets, and the SEC deserves credit for identifying this problem in RegNMS.

RegNMS proposes to make one trade-through rule for both the OTC and Listed worlds. Currently, there is no trade-through rule at all in the Nasdaq-listed market. RegNMS includes language for potential rules for both OTC and Listed trading. However, they ask for extensive public comment on what actual changes will be needed to make these rules work effectively. The SEC recognizes that there are many ways to address each issue in the proposal, and rightly asks for comments on the various options.

The key proposal in my opinion is a concept that would greatly enhance investor power and choice over their trades: an “opt out” exception. This exception would allow informed investors to choose, on an order-by-order basis, to opt out of being forced to have their orders sent to a market that may have the best advertised price when investors believe that chasing this price, which may not be available, is not in their best interests. An investor’s broker would be required to obtain the investor’s informed consent prior to executing an order pursuant to this exception. The SEC’s idea is that an informed investor should have more choice in how their trades and executed is the correct one. Whenever choice exists in a market for service, the best service wins and the standard for all service rises.

While the opt-out clause holds out the promise of a major step forward for the markets, much will depend on the wording of the final rule. The SEC must make the actual process of opting out on a particular order as simple as possible, in order to make the actual process simple to implement and the rule straight forward to comply with. The fact is, the value of this exception is contingent on its ease of use and implementation: the more difficult it is to opt out, the less valuable the exception will be.

The other main topic addressed in RegNMS involves Market Data Revenue. Historically, the vast sums made off the collection and dissemination of stock quotes and trade information are shared among the Exchanges on the basis of their market share of reported trades. This is an imperfect system, as I noted in a letter to the SEC in early 2002, before we started sharing this market data revenue with our customers. It equates the value of a 100 share trade with the value of a 1,000,000 share trade. The information value of these two trades is not equal. I don't have any penetrating insights on potential formulas or structures for this data revenue sharing process. The more central question is how this data should actually be priced. What is the right price for market data? I believe that the correct answer to that question can only be answered by the free market.

Mr. Chairman, it is an honor to have had this chance to present my perspective on these critical public-policy issues. These hearing today, and the SEC's timely RegNMS proposals, present all of us with a compelling opportunity to shape the future of our Nation's equity markets and ensure their continued strength and prosperity. As we consider the various proposals under discussion, we must be careful to embrace the competitiveness and innovation which has made our markets the envy of the world.