The Investor First:

Enhancing the Existing Protections and Benefits of the Agency-Auction System at the New York Stock Exchange

Testimony of
Robert H. McCooey, Jr.
President and Chief Executive Officer
The Griswold Company, Incorporated
Member, New York Stock Exchange

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"Reviewing U.S. Capital Market Structure: Promoting Competition in a Changing Trading Environment"

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Chairman Baker, Ranking Member Kanjorski and Members of the Subcommittee:

My name is Robert McCooey. I am a proud Member of the New York Stock Exchange and President and Chief Executive Officer of a New York Stock Exchange member firm, The Griswold Company, Incorporated. Griswold is an agency broker executing orders for institutional clients on the Floor of the NYSE. As an agency broker, we execute trades on behalf of our customers. We do not make markets in securities or engage in proprietary trading. Our clients include some of the largest mutual and pension funds in the United States.

Thank you for inviting me here today to testify in connection with your review of the capital markets structure here in the United States. I am not here today to speak about recent events related to our Board of Directors, compensation, or the specialist system that have occurred at the Exchange during the past few months. I am also not here to discuss the new governance initiatives that have been proposed. I believe that our interim Chairman John Reed had laid out his plan for the NYSE during his testimony two weeks ago. He presented a very progressive and ambitious agenda to deal with the governance issues that currently challenge the NYSE. As an owner and leader of a firm that owns several NYSE seats, I support the plan that John has put forward to remedy the structural conflicts inherent in today's system.

My focus today will be on the major market structure issues that are currently under review by the House Capital Markets Subcommittee, your counterparts on the Senate side and at the Securities and Exchange Commission. Others would like to paint this debate as one about the New York Stock Exchange and its future. It is not. And never should be. This is not to downplay the impact that decisions made in this committee will have on the future of the New York Stock Exchange and the important place that the NYSE currently serves in the capital raising process here in the United States. The discussions that we engage in today must focus on one major thought: How do we enhance the National Market System for the benefit of all investors while ensuring a fair and level playing field on their behalf? In the process of answering that charge, we must also protect the aspects of the current National Market System structure that continue to provide positive results in the execution of investors' orders. I would contend that the agency-auction market model at the New York Stock Exchange is one of these important competitive aspects of the National Market System.

As an agent on the Floor of the NYSE for the past 16 years, I have seen the evolution of Floor Brokers from providing outsourced executions for the major broker-dealer firms to establishing themselves as strategic partners for institutional clients. Increasingly, the goal for clients has been to find ways to gain efficiencies in the execution process by getting closer to the point of sale. Independent agents working on behalf of these customers now furnish real time market information coupled with tremendous costs savings to these institutional customers. I would also remind the committee that the assets that are managed by my customers are owned by the small retail customer, the pensioner, the parent saving for college, the worker funding their IRA and all the others who invest in equities traded here in America. Today in the United States, when we talk about doing what is right for the marketplace and the participants in that market, we must realize that the retail customer and the institutional customers are one in the same. They are all our assets; institutional is just a larger commingled pool.

Floor brokers play an important role in the price discovery process. The competition between orders represented by brokers at the point-of-sale on the Floor of the NYSE helps to ensure fair, orderly and liquid markets. It is the Floor broker who will seek out contra side liquidity for an order as well as make decisions based upon rapidly changing market dynamics. The Floor broker serves as a single point of accountability and information – not found in dealer markets and ECNs – and who employs the most advanced technology to support his or her professional judgment. The interaction between the Floor broker and the upstairs trader provides the flow of information necessary to keep those customers informed about changing market conditions. That information flow is more often than not the catalyst that provides incentives for traders to trade. The combination of best price and intelligent information flow is the backbone of the NYSE.

NYSE competitors have claimed a supposed technology advantage. The reality is quite the opposite. During the past decade, the NYSE has invested more than two billion dollars in technology for our trading floor, data centers, and new product and service development. The NYSE Floor has one of the largest deployments of flat screen technology anywhere. Brokers no longer write on little slips of paper and have "pages" transport the information from point-of-sale to a phone clerk for relay to our clients. The agent relies upon a digital handheld communication device, which receives the order, transmits the reports (often directly to the customer) and engages in an ongoing dialogue with the client through the use of digital images. All of this is accomplished without ever leaving the trading crowd.

Investor Protection

As a registered broker and fiduciary entrusted with orders from my customers, it is amazing and unsettling to me that so many speak so openly and with such a cavalier attitude about breeching their responsibilities to their clients. Clearly, what I am referring to are the proposals to modify or eliminate the "trade-through" rule. The "trade-through" rule was designed to convert multiple competing markets into a National Market System. The rule turns each market into a gateway to every other market and ensures that investors will not be disadvantaged by virtue of having bids or offers displayed in one market versus another.

When trading is allowed to occur outside of the National Best Bid and Offer (NBBO), two investors are being disadvantaged – the bid or offer that has been posted as well as the buyer or seller who received an inferior price to the NBBO. To amplify this, I would like to offer the following example: A buyer posts a bid of $49.05 to buy 5000 shares of XYZ, the stock is offered at $49.10. In the absence of a "trade-through" rule, a trade of 5000 shares might occur at $49.00. In this instance, two investors are not being afforded the full protection that they deserve in the marketplace. The seller who sold stock at $49.00 did not receive the highest price that was bid for those shares in the market. Further, the buyer with the $49.05 bid is left unfilled. This investor posted the best bid in the marketplace and was ignored. I do not believe that this is the message that we want to disseminate to the investing public. Unfortunately, this is a message that is being promoted by some competitors.

<u>ITS and the "Trade-Through" Rule</u>

Some competitors would have you believe that the Intermarket Trading System (ITS) was put in place for the sole purpose of allowing the NYSE to retain its place as the world's preeminent market. The New York Stock Exchange did not devise the ITS Plan all those years ago and is a sole voice among all the competing market centers that must belong to ITS. I am not going to argue that the current system is perfect. Far from it. The Intermarket Trading System certainly is in need of reform, or possibly elimination. With the technologies available today, there are certainly market linkages available that would (possibly) be acceptable to all. However, the challenge here is to maintain the integrity of the market and protect the least sophisticated user of it.

The most important starting point for any trade through discussion must be the facts, and how the facts impact every investor. In my opinion, some of those who have sat here before you prior to today have engaged in competitive positioning rather than factual presentation – in the name of self-interest, not with the interests of all investors in mind. Simply stated, the facts do not support their contention of the "unfair" system that stifles competition. At the New York Stock Exchange we welcome competition. However, that competition must be one that ends with the execution of a customer's order at the best price available in the marketplace. The reality is that the NYSE posts the best price nearly 94% of the time in our listed securities. In the 100 most actively traded securities, NYSE prices are on average 12 cents better that our competition.

Additionally, we have the benefit of a feature that no other marketplace offers: Price Improvement. Each day, the NYSE improves the posted price on 44% of the orders that it receives by an average of 3 cents per share. You want speed? We have it. Market orders of 500 shares or less are executed in under 5 seconds 50% of the time. A small order auto-execution product, NYSE Direct+, turns around orders in 1.3 seconds. Order sizes of 500 to 2000 shares are executed in under 5 seconds happen 40% of the time. I use these examples because they are representative of the execution size in the NASDAQ market. In these instances as well as almost all other orders delivered to the NYSE, price improvement was available and received in 44% of the cases. Even in larger order size category the NYSE sets the standard for all others to compete against. We are tied for fastest market for large orders, those of 10,000 shares or more. In contrast to the information offered by others to the committee the average execution speed for those larger orders is 19 seconds, not the sub-second times that some would have you believe.

The most damaging information to the anti-"trade-through" rule crowd is again undisclosed to the lawmakers and regulators that they are attempting to persuade. The baseless claim is that the ability for them to trade at inferior prices to those available in the marketplace is necessary because when they send a commitment to the NYSE to access those prices they are no longer there. The reality you ask? The fill rate on the NYSE for market and marketable limit orders is 83%. Our rate compares very nicely when you line it up next to the fill rates that customers should expect when they attempt to access the liquidity offered on an ECN or NASDAQ. One of our most vocal critics, ArcaEx, boasts a fill rate of 45% and NASDAQ fills less than half at 47%.

Substantively modifying or eliminating the trade-through rule would produce inferior prices and increased costs, contribute to market fragmentation and market volatility, and reduce accountability and transparency. This is not the way to restore investor trust and confidence.

A Penny Saved is a Penny Earned

With thirty co-sponsors, Chairman Michael Oxley sponsored **H.R. 1053** "to eliminate legal impediments to the quotation in decimals for securities transactions in order to protect investors and to promote efficiency, competition, and capital formation." Recognizing that there are some in the financial community who would like to put forward the concept of trading in nickels rather than pennies, the fact is that currently we trade in pennies. It has now been almost three years since that dramatic shift in the way securities are traded and we have survived.

Arguments were made at that time about the tremendous savings to investors from the shift to decimal pricing of securities. Speaking to support

"The Common Cents Pricing Act of 1997" Herbert L. Dyer, Executive Director of the State Teachers Retirement System of Ohio told this House Committee that decimals "could save our teachers and retirees millions of dollars annually." J. Kenneth Blackwell, Treasurer of the State of Ohio, explained his support for the legislation by saying that "Decimalization will encourage the laws of free trade to regulate our exchanges, thereby alleviating the need we now have for many of the rules governing trading in our markets." Savings to investors and competition to provide the best and most fair markets to investors; these were the goals and results of this groundbreaking legislation.

So, what happened along the way to the penny? Has something changed in the Congressional mind in these few short years? Do investors no longer deserve to save money? Have we decided to encourage investors to ignore the best price available in the marketplace? Should investors be prohibited from the opportunity to garner the highest return for the capital that they have invested? Is it acceptable for major mutual fund to publicly state that they would accept a worse though speedier price for the stocks that they are buying and selling on behalf of the millions of shareholders who have entrusted them with their hard earned money?

There is, however, an answer to these questions about the penny. I think that somewhere between "Common Cents" and today, client interests have been abandoned and replaced with ones that are self-interested. During a difficult period for both the financial markets and broker-dealers, client interests have been secondary to the economic interests of firms and market centers. It is not time to encourage or reward this type of behavior. Quite the contrary, the message of "The Investor First" should be quickly and firmly re-enforced.

Pennies add up. And to be fair to my colleagues at the NYSE, I should probably be using the three cents of price improvement that I referenced earlier and that a significant percentage of orders receive. However, I will continue to use the smallest increment and its value because the dollars still add up quickly. If fiduciaries are abdicating their responsibility to achieve the best price available, the impact to their shareholders (THE PUBLIC) is very significant. If the major mutual fund that I cited earlier does forgo better available and accessible prices for the sake of speed, the negative cost impact to the fund's shareholders is in the millions of dollars. For a fund trading an average of ten million shares a day (not unusual today), to receive that incremental penny of price improvement on all those shares and multiplied by 250 trading days in a year, the savings are twenty-five million dollars ($25,000,000). This is the shareholders money. This is the investing public's money. Furthermore, I am only giving you one example of just one fund manager. Across thousands of funds and billions of shares traded, the potential negative impact to investors cannot be ignored. Honestly, the dollars lost by this deplorable activity will make the recent market timing and rapid trading of funds look like a misdemeanor.

Finally, we have come to the place where we can answer our question. How do we enhance the National Market System for the benefit of all investors? We begin with what has worked for years and continues to work today. We start with a market that provides liquidity, accessibility, transparency, the highest certainty of an execution, protection for customer's orders and their interests. That market is the agency-auction system at the New York Stock Exchange. At the NYSE, we will continue to change, adapt and innovate to best serve our customers and to fulfill our commitment to producing the highest levels of market quality. We must continue to provide the fair and level playing field that investors want and expect from us. We will compete on the basis of discovering and delivering the best price coupled with the highest levels of transparency. Anything else disadvantages investors and is wholly unacceptable. In all that we do, we take pride in the fact that we always place "The Investor First".

Thank you. I will answer any questions that you may have.