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STATEMENT OF

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on

DARK POOLS, FLASH ORDERS, HIGH FREQUENCY TRADING, AND OTHER MARKET STRUCTURE ISSUES

before the

SUBCOMMITTEE ON SECURITIES, INSURANCE, AND INVESTMENT
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
U.S. SENATE

October 28, 2009
Room 538, Dirksen Senate Office Building

INTRODUCTION

Chairman Reed, Ranking Member Bunning and members of the Subcommittee, thank you for the opportunity to testify this morning on current issues affecting U.S. market structure. As a fully transparent and neutral player in the industry, I would like to offer ITG's unbiased, fact-based perspective on these issues to help you better understand the current trading landscape.

ITG is a NYSE listed Company with 18 offices across 10 countries employing nearly 1,300 people worldwide. As a specialized agency brokerage firm, ITG provides technology to a broad collection of the globe's largest asset managers and hedge funds, allowing them to independently source liquidity on behalf of their clients. Throughout our 22-year history, we have grown our business in the best traditions of U.S. innovation and market leadership.

In 1987, POSIT was launched as one of the first "dark" electronic matching systems. Since then, ITG's POSIT crossing system has harmoniously existed within U.S. market structure, including the Regulation ATS and Regulation NMS frameworks in more recent years. We firmly believe that institutions need a place to confidentially interact with each other to find natural block liquidity. Non-displayed pools of liquidity such as POSIT provide a valuable solution for the buyside to comply with their obligations as fiduciary to offer their clients the best possible execution. Our analysis of millions of institutional trades post the advent of Regulation NMS confirms that POSIT reduces market impact of block trades and enhances execution quality.

In my testimony today, I will begin by addressing the role of "dark pools" and other undisplayed quotes historically in our markets. I will outline the advantages non-displayed pools of liquidity provide for the marketplace, along with the concerns that exist today about the activities within such pools and their effect on the broader markets. I will then describe the effects of high-frequency trading on the markets, and discuss the advantages and disadvantages that have been cited for such techniques. Finally, I will provide our views on several topics that seem destined for further regulatory scrutiny: sponsored access and exchange co-location.

DARK POOLS

Contrary to their pejorative name, dark pools have played a positive role in the transformation of the U.S. equity markets over the past decade. As SEC Commissioner Kathy Casey herself points out, there is nothing sinister about dark pools; they exist for legitimate economic reasons. Institutional investors seeking to make large trades have always wanted to avoid revealing the total size of their order. This, in turn, benefits the millions of individual investors who invest in mutual funds and pension plans. Without a facility like POSIT, institutions with a natural interest in trading with one another would be subject to unnecessary frictional costs.

We whole-heartedly embrace and support the broad concepts the SEC highlighted during its open meeting last Wednesday. The staff of the SEC's Division of Trading and Markets exercised a tremendous amount of care and diligence in their examination of

current U.S. market structure. We interpret the SEC's recent pronouncements as establishing a bright line between truly dark pools and lit pools with an exception for block liquidity. We welcome the clarity. As a truly dark pool, POSIT will continue to provide large executions and price improvement to its customers.

Academic research demonstrates that market fragmentation (including the proliferation of dark pools and other off-exchange trading venues) does not harm market quality. We support efforts to increase post-trade transparency, so long as the rules are applied consistently across the competitive landscape. In fact, we believe that the data arising from such transparency will better enable market participants to measure the quality of the executions that they receive from the various trading venues, thus enabling them to make better routing decisions in the future.

INDICATION OF INTEREST

Indications of interest, commonly known as IOI's, have become a commonly accepted method by which brokers and their clients communicate trading interest to one another efficiently. In the past couple of years, IOI's have empowered what we consider to be a potentially harmful mutation in market structure by which various ATSs can in effect create an "inside" market by sharing actionable IOI's selectively while still operating with no requirement to display that message. This practice has the potential to create a two-tiered market of participants with and without access to information. The SEC has deservedly focused on this issue and is recommending appropriate action to eliminate the grey area between lit and dark marketplaces.

HIGH FREQUENCY TRADING

As a pure agent and independent observer of high-frequency trading, ITG does not have a stake in the use of this practice. However, we are committed to looking out for the best interests of our clients and the future of U.S. market structure. We hold the view that high-frequency trading plays an important role in the marketplace. Specifically, high-frequency firms take risk, commit capital, and provide liquidity in all market conditions.

In today's highly evolved market, these high-frequency firms are both large customers of exchanges/ECNs as well as some of their strongest competitors. Accordingly, these firms are able to provide cost saving opportunities for broker dealers that are ultimately passed on to retail and institutional investors. Many of the high-frequency firms are broker-dealers and, as such, are subject to the oversight of the SEC and FINRA. Furthermore, many serve both institutional and retail clients and are critically assessed on the quality of their execution. Hence, these firms do not fly under the regulatory radar.

SPONSORED ACCESS

However, we do have concerns about "sponsored access" and the risks it potentially creates for market participants. Sponsored access generally refers to the practice of a broker-dealer member of an exchange providing other market participants (possibly non-regulated entities) with access to that market center without having the sponsored participant's orders flow through the member's systems ***prior*** to reaching the market center. One of the concerns associated with sponsored access is that the service can be

provided without rigorous compliance oversight and/or appropriate financial controls. We believe that the issue of sponsored access firms deploying high-frequency strategies on behalf of non-regulated entities deserves regulatory scrutiny.

It is important to realize that the issues of high frequency trading and sponsored access are not black and white. Clearly, outsized returns generated by questionable trading practices must be scrutinized. However, retail and institutional clients benefit greatly today from the liquidity provided by high frequency firms, which generate reasonable returns in relation to the risk they assume. To impair that through broad-brush regulatory intervention without a targeted focus on abusive practices and the potential risks of sponsored access could possibly harm the continuity and quality of U.S. equity markets.

EQUAL ACCESS TO THE MARKETS AND EXCHANGE CO-LOCATION

U.S. exchanges have logically become mission critical technology providers to the brokerage industry. They now “host” brokerage firms within exchange owned and operated data centers and provide access to the circulatory and respiratory system of today’s national market system: market data and the matching of executed trades. It is our hope that the SEC will provide similar clarity on the issue of co-location within exchange data centers in a future concept release. No firm should enjoy an advantage over another firm based on physical proximity to exchange technology. Principles of fair access and transparency must be applied equally to this issue

CONCLUSION

While we support the SEC's recent proposals, we are wary of the dangers of unintended adverse consequences for market structure. We note that Regulations ATS and NMS did produce the competition and innovation that they were intended to foster without compromising investor protection. The increased competition evidenced by the existence of approximately 40 execution venues in the U.S. market has reduced transactions costs and increased executions speeds without degrading the transactional or informational efficiency of the U.S. equity markets. To the contrary, U.S. market systems withstood the demands of unprecedented volatility and transaction volumes through the financial turmoil of last fall with remarkable stability and resiliency. The confidence that global investors have in the efficiency of the U.S. National Market System is well placed. This confidence is essential to U.S. leadership in the formation of capital. All of our collective efforts towards structural reform must focus on the preservation of this confidence.

EXHIBIT A

Biography of Robert Gasser, CEO and President of Investment Technology Group

Bob Gasser is Chief Executive Officer and President of Investment Technology Group. Mr. Gasser was previously CEO at NYFIX, Inc., a global electronic trade execution firm. Before NYFIX, Mr. Gasser was Head of U.S. Equity Trading at JP Morgan. Concurrently, Mr. Gasser served on the Board of Directors of Archipelago Exchange as well as on the NASDAQ Quality of Markets Committee and the NYSE Upstairs Traders Advisory Committee. Mr. Gasser holds a Bachelor of Science degree from Georgetown University, School of Foreign Service.

EXHIBIT B: "Culs de Sacs and Highways, An Optical Tour of Dark Pool Trading Performance," Ian Domowitz, Ilya Finkelshteyn and Henry Yegerman, August 2008