Statement of

Christopher Nagy
Managing Director of Order Routing Strategy
TD Ameritrade

for the

Subcommittee on Securities, Insurance, and Investment
Committee on Banking, Housing, and Urban Affairs
United States Senate

Hearing on

Dark Pools, Flash Orders, High Frequency Trading, and Other Market Structure Issues

October 28, 2009

Chairman Reed, Ranking Member Bunning, and members of the Subcommittee, thank you for the opportunity to testify on equity market structure issues. I am Chris Nagy, Managing Director of Order Routing Strategy for TD Ameritrade.[1]

TD Ameritrade, based in Omaha, Nebraska, was founded in 1975 and was one of the first firms to offer negotiated commissions to individual investors following the passage of the Securities Act Amendments of 1975. Over the course of the next three decades, TD Ameritrade pioneered

[1] TD AMERITRADE is a wholly owned broker-dealer subsidiary of TD AMERITRADE Holding Corporation ("TD AMERITRADE Holding"). TD AMERITRADE Holding has a 33-year history of providing financial services to self-directed investors. TD AMERITRADE Holding's wholly owned broker-dealer subsidiary, TD AMERITRADE serves an investor base comprised of over 5.2 million funded client accounts comprised from every state in the union with approximately $289 billion in assets (as of August 2009). TD Ameritrade continues to focus on serving individual investors, providing low-cost services, ranging from completely self-directed investors to those served by registered independent advisors. During August 2009, TD Ameritrade handled an average of 431,000 investor trades per day, representing an average of 478 million shares per day. We do not directly execute client orders, but rather act as agent in routing orders to the marketplace. We use our position in the marketplace to drive the markets to compete on price and cost. As a result of our efforts, during June-September 2009, we were able to obtain price improvement for 66% of our client share orders and saved our clients $12.5 million by getting them better than the then best price when they entered their order.

technological changes such as touch-tone telephone trading and internet investing to make market access by individual investors more accessible, affordable and transparent.

TD Ameritrade has long advocated for market structures that create transparency, promote competition, and reduce trading costs for individual investors. As technology rapidly advances, it is ever more important that the SEC complete a comprehensive review of the National Market System to ensure individual investors are not adversely impacted. At the same time, regulation has the potential to result in unintended consequences, making it critically important that rulemaking be based on empirical data and reasoned analysis.

Our nation's stock markets have evolved dramatically in the last decade. In 2001, the average individual investor transaction took upwards of eighteen (18) seconds to receive an execution while today that same transaction is done in less than one (1) second. These changes primarily have been driven by technological innovation, but also in response to carefully crafted regulations. In fact, today the individual investor enjoys superior pricing, lightning fast trade fulfillment, and ample liquidity. At no other point in the history of the markets has the individual investor been closer in terms of pricing with the institutional trader.

Gone are the days of slow human traded manual markets. The decline in manual trading was not only due to technology, but also Regulation NMS, which was designed to encourage fast quotes and limit order display, with the goal of ensuring investors obtain the best prices available in the markets. We also have witnessed a proliferation of market center competition for order flow, a result of technological innovation and Regulation ATS which lowered the barriers to entry. In addition, the move to decimalization early in this decade reduced spreads by up to 5 ¼ cents whose benefits went largely into the pocketbooks of individual investors.

It is natural in a highly competitive environment, particularly when combined with rapid technological innovation, for market evolution to occur. The facilitation of a National Market System, as called for in the Securities Acts Amendments of 1975, has provided a framework for this market evolution. As such, regulation has always been an integral part of the development of the National Market System, with the SEC refining rules such as requiring quote displays and ensuring that trades are rarely executed at inferior prices.

Dark Pools

Variations of Dark Pools have been in our markets for decades taking on various forms from a broker taking an order from an institution over the phone to a floor broker acting as agent on an order received via teletype. When Regulation NMS was enacted in 2005, exemptions to the display rule were granted spawning the creation of the modern day electronic Dark Pool. Because of decimalization, the declining size of the quotes, and the need to minimize market impact, institutional traders began seeking block trading alternatives or algorithmic trading. This market dynamic has given rise to well over forty Alternative Trading Systems transacting, by some estimates, 35% of all stock market orders each day. Retail clients have little ability to interact with these growing pools of liquidity. The irony is that dark orders receive their pricing from the transparent exchanges where retail client trades are executed. In many ways, Dark Pools are an excellent example of a two-tiered market that gives institutional traders a way to use retail order flow to their own benefit. Certainly no one intended for these exemptions to lead to such a stark, two-tiered system of trading. While there is benefit to Dark Pools reduce overall market impact, serious questions need to be asked if we have reached the tipping point.

Flash Orders, High Frequency trading and Market Access

Innovative strategies that promote efficiency and reduce investor costs in the markets are critical if we are going to continue to level the playing field for individual investors. There has been much fanfare that flash trading is harmful to retail investors, however little data is offered to back these claims. Defenders of Flash argue that it allows users to lower transaction costs and obtain better prices in both the equity and option markets. Interestingly, it is estimated that Flash trading accounts for less than 2% of all market activity. Although TD Ameritrade can find no evidence that flash trading harms individual investors, our firm believes that Flash is a symptom of our current two-tiered market structure and that in many ways the perception that it is unfair and predatory became the reality. We fully support the SEC's goal of ensuring that Flash is not used to further two-tiered access and we support a comprehensive solution in this area.

High Frequency Trading on the other hand is estimated to be as high as 75% of all daily trading volume on our stock exchanges. The benefits cited are that High Frequency Trading provides additional liquidity to the markets. While perhaps true, the issue of High Frequency Trading is not of liquidity but rather one of capacity utilization. While High Frequency traders send millions of orders to exchanges they also send an equal number of cancellations leading to low fulfillment rates. Some stocks can see more than seventy (70) quote changes in a single second because of this activity. The sheer volume creates technological issues for the dissemination of market data to individual investors as they receive such data in their homes perhaps thousands of miles away from the originating source. Meanwhile, High Frequency Traders subscribe to specialized data feeds and situate their technology on the exchanges' property, otherwise known as Co-location. While Co-location improves speed of execution for all parties including individual investors, oversight on how this process is administered is non-existent. Moreover, some exchange members provide High Frequency Traders with direct access to the markets. These arrangements create systemic risk by allowing High Frequency Traders to act as de facto specialists without the capital obligations and at little cost while the rest of the market picks up their tab.

Conclusion

As we embark on an overhaul of our nations markets it is imperative that we continue to provide a low cost, competitive infrastructure that ensures individual investors have low barriers of entry, which, in turn, promote investor confidence and long-term investment into our nations' markets. We must, however, ask if we have reached the tipping point with an excess of Alternative Trading Systems. Interestingly we can draw insight from a very different yet similar circumstance. During the great depression there was an overabundance of taxi drivers, which reduced driver earnings and congested city streets. To address the issue and restore a proper balance, the Medallion system was created placing a moratorium on the issuance of taxicab licenses. This system created the proper balance of taxis while not crowding city streets. In today's markets as we emerge from the recent market downturn, one must question if we have "too many taxis" fragmenting the streets of liquidity. We should seek a solution to provide competition in our markets without an over surplus of trading systems.

I appreciate the opportunity to appear before the Committee not only on behalf of TD Ameritrade but more importantly on behalf of our clients, individual investors.