United States Senate
Committee on Banking, Housing and Urban Affairs
Washington, DC 20510
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Dear Chairman and Committee Members,

First, thank you for holding this hearing. The US equity markets have long been a pinnacle of market efficiency and investor protection and critical to economy. However, to maintain our leadership we ought to examine our system in order to make sure it supports a wide range of investors.

During my career, the markets have undergone unprecedented regulatory and technological change. I entered the industry in 1998, designing retail order routing logic. In those days, executions would take minutes. When I left Ameritrade in 2004, executions were measured in seconds, and today they are measured in milliseconds.

Now, as Director of Research at TABB Group, a financial markets research and consulting firm, I am part of an organization dedicated to helping market professionals understand the trading landscape. Our clients span the professional investment community from pension plans, mutual funds, hedge funds, high frequency firms, and brokers, to Exchanges and ATSs. Our studies put us in constant dialogue with head traders of our nation's top money management firms. Indeed, a forthcoming piece of research, based on conversations with head traders at firms that manage 41% of US institutional assets, is on the topic we are here to discuss.

For institutional money managers, trading is a balance between price and time. If order information is not handled carefully execution quality can deteriorate, which would harm pensioners, retirees, and investors. Time-sensitive orders tend to be widely disseminated in order to increase the speed of execution, while price-sensitive orders stay dark to minimize impact on the stock. The tradeoff between dark and lit is never black and white as instructions differ, liquidity patterns are not consistent, and market conditions change.

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While dark pools are new, underlying trading principles have not changed since the Buttonwood tree. Large orders influence the market and will never be fully unveiled. As trading has evolved to rely on automated tools to facilitate decision making and execution, we need to ask, “What tools should investors have to control the dissemination of trading information?” In the past, traders gave large price-sensitive orders to NYSE Floor Brokers. Now traders have the ability to codify the execution decision and more closely manage how that order interacts with the market. The complex mechanisms of today’s market reflect the competition to provide traders with state-of-the art tools.

TABB Group’s concern about dark pools is ensuring that traders who utilize these pools adequately understand their execution process. We have seen much progress on this front. This year, 71% of traders we interviewed were comfortable with dark pool practices, up from 53% in 2008. The increased voluntary disclosure by dark pools is a positive step. TABB Group believes that there should be even greater dark pool order handling disclosure so traders can be sure their intentions are properly fulfilled. While we believe in disclosure, we do not necessarily believe in pre-trade or real-time post-trade dark pool transparency, especially for small or mid-cap stocks. The dissemination of this information in real time can harm execution and force liquidity into other more manual dark forms. In this situation, end of day disclosure is more desirable.

Opposite dark liquidity is high frequency trading (HFT). Markets require intermediaries to provide liquidity. In the past they were called specialists or market makers, while today we call them high frequency traders. Little has changed in providing liquidity except speed. HFT is merely an outgrowth of the regulatory and technological progress reflecting the cost of immediate liquidity. Among the institutional investors we spoke with 83% feel HFT has either a positive or neutral impact. Those that believe HFT has a positive influence on the markets cited the added liquidity and tighter spreads as key benefits. Those that are neutral believe the responsibility of execution quality rests on their shoulders. The 17% that believe HFT has a negative influence on the market feel as if HFT profits represent an unnecessary liquidity tax on their investors.

Finally, it is important to make the important distinction between flash orders and high frequency. Flash orders at their height represented only 3% of overall share volume. With BATS and NASDAQ discontinuing the process, flash represents a small and decreasing fraction of overall equity market volume. Flash orders are another tool used to balance price and time – trading off information for a better price or more volume. Flash has existed for years on the NYSE Floor and on the market maker's desk, albeit manually. For flash trading, TABB Group believes disclosure is paramount and the ability to opt-out a must:.

Trading is both an art and a science. To effectively balance the price/time tradeoff, traders need a variety of tools. When we want to tread lightly, we trade in the dark. When immediacy is virtue, we take liquidity from wherever we can. As our markets evolve, so must our tools. No one idea trumps all others and a single market does not serve all. It is this competition among and within these different investment philosophies, trading strategies, and market structures that creates a more efficient marketplace for all market participants.

With that, I would like to thank this committee for its time.