Testimony of
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US Senate Banking Committee Hearing Titled:
“Regulation NMS and Developments in the Equities Markets”
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Chairman Shelby, Ranking Member Sarbanes, members of the committee, thank you for holding this hearing and for inviting me to speak before you today.

My name is Ed Nicoll and I am the CEO of Instinet Group Incorporated. Through our affiliates, we provide sophisticated electronic trading solutions that enable buyers and sellers worldwide to trade securities directly and anonymously with each other, interact with global securities markets, have the opportunity to gain price improvement for their trades, and lower their overall trading costs.

The U.S. government today – in the form of the SEC, Reg. NMS and the oversight provided by Congress – is basically debating whether or not to allow true competition between America’s stock markets or to keep in place the status quo. Simply said, competition and openness will benefit investors more than the status quo or mere “window-dressing” reforms.

In 1975, Congress tasked the SEC to create the National Market System (or “NMS”) and provided it with a roadmap for developing a market structure designed to preserve and strengthen our markets. But over the past three decades, new trading technologies have had an incredible impact on our financial markets. With these advancements, there is now general consensus that one of the key market rules, the trade through rule, is outdated. Even those calling for minimal reforms are not arguing that no change is needed.

Despite the recognition that the rule is outdated and actually undermines market efficiency, many want to retain its core principles rather than eliminate it or provide an effective way to opt-out of its prohibitions. Those arguing in favor of retaining the trade through rule assert that trade throughs lead to investor confusion, fewer limit orders, reduced liquidity and, given the hyperbole of some, the collapse of our financial markets.

But we already know what happens in the absence of a trade through rule. In particular, when we compare a market without a trade through rule - the market for Nasdaq securities - to a market with a trade through rule - the market for NYSE securities - we see that the Nasdaq market provides investors with execution quality that is as good as, and in many cases better than, that of the NYSE. This is borne out by the SEC's own mandated execution quality statistics, as well as other analyses that we submitted with our comments on Reg. NMS and which I ask be included in the record.

Nevertheless, the SEC is currently considering adopting a new trade through rule that would continue to prohibit market participants to trade through advertised prices of so-called "fast" markets. In short, the government would designate an arbitrary speed limit for the marketplace. The NYSE is attempting to gather support for the "fast" market proposal by making its system just automated enough so that the SEC will designate it as a "fast" market. Ironically, these changes by the NYSE only serve to underscore the benefits of eliminating the trade through rule or adopting an effective opt-out provision.

But the issue with a trade through rule is not related to speed. It is that the rule substitutes the judgment of the Federal government for that of the marketplace – thereby distorting competition and inhibiting innovation. Many of the traditional market participants, with high cost structures, find themselves unable to compete with new, nimbler competitors who are able to adapt to consumer demands. In the face of declining trading profits, it's hardly surprising that they seek assistance from the government to slow down the changes in the marketplace.

But do we really want to hamstring the most technologically advanced markets, with a proven track record of delivering increased value to investors, in order to protect the old way of doing things? The cost of any regulatory approach that inhibits new methods of trading efficiency will be borne by investors who will pay more when they buy and sell securities. The question becomes, will SEC rules foster technological growth or cling to an outdated regulatory structure that inhibits it?

We should also consider the limited proposal to reform the trade through rule in the context of the other elements of proposed Regulation NMS such as: 1) fixing the prices a market can charge; 2) fixing the increments in which they can trade; 3) dictating terms of access; 4) establishing the terms and price for each market's data; and, 5) limiting transparency and information sharing in order to protect consumers from "confusing" bids and offers. I ask that the executive summary of our comment letter to the SEC, which discusses these issues, be included in the record.

On top of all this, effectively setting a speed limit for markets by defining "fast" could result in denying markets one of the last ways they have to compete against one another. I cannot imagine that we want to limit – rather than promote – competition in the most efficient, dynamic markets in the world. In fact, some might wonder whether Congress' call for a National Market System is getting closer to a "Nationalized" Market System – and not the diverse system of competing markets that Congress originally envisioned. Our markets have long been the best and strongest in the world. We cannot bury them in regulatory mandates and micromanage their operations like we do the local power plant or phone company and not expect to eventually pay a price in terms of our global competitiveness.

The NYSE's publicly stated intent to reform its internal processes only underscores the benefits of eliminating the trade through rule. It is no coincidence that the NYSE is considering ways to make its market more efficient and electronic at the same time that we are all here to discuss the fate of the trade through rule. The NYSE's timing proves our point. If the trade through rule were not in some way protecting its business, then the NYSE would not be making such an effort to defend it. But innovation can't be limited to time periods when regulations are under review. It must be continuous and spurred by competition. That is why we simply need to either eliminate the trade through rule or adopt an effective opt-out.

Anything less and we risk squandering both this opportunity for reform as well as our position as the pre-eminent capital market in the world.

Thank you for the opportunity to address you today and I look forward to answering any questions you might have.