# Testimony of Larry Leibowitz, Executive Vice President and Co-CEO of Schwab Soundview Capital Markets Before the United States House of Representatives' Subcommittee On Capital Markets, Insurance and Government Sponsored Enterprises May 18, 2004

Chairman Baker, Ranking Member Kanjorski, distinguished members of the Committee, my name is Larry Leibowitz. I'm Executive Vice President and Co-CEO of Schwab Soundview Capital Markets, the institutional trading, research, and retail execution arm of The Charles Schwab Corporation. Thank you for the opportunity to speak today on the vital market structure reforms proposed by the Securities and Exchange Commission.

Schwab Soundview Capital Markets, as the largest Nasdaq market maker by volume, and Charles Schwab & Company, with its millions of retail customers, believe that the time is ripe for modernization of our national market system. We process millions of orders a day and these orders are directly impacted by the conflict between modern technology and the antiquated rules from an era marked by human interaction when trading securities. These rules primary serve to insulate outdated and inefficient manual markets from competition, and actually harm, rather than protect, investors.

For too long competition has been stifled in the market for NYSE and Amex-listed securities. Given the very limited time available, I will focus my prepared comments on the two main culprits—the so-called "Trade Through Rule" and the current market data system.

**Trade Through Rule**

The Intermarket Trading System ("ITS") Trade Through Rule purportedly protects investors from inferior prices, but has actually insulated the NYSE and its specialist system from competition and protected its privileged position. Given the NYSE's role in the creation of the original Trade Through Rule, the rule has worked as it intended – to protect its monopoly profits.

Being forced to route orders to manual markets for execution lowers efficiency and, in some cases, actually undermines a broker's duty of best execution. A better alternative is available. When securities are traded in an automated environment without a Trade Through Rule, as they are in Nasdaq today, investors obtain greater order protection, faster executions and better prices. Investors are protected by the broker-dealer's overriding obligation to provide best execution to customers.

In addition, when a market is efficient, you don't need a rule prohibiting trade throughs. They simply do not happen. And you don't have to take my word for it. The Commission's own order handling statistics, the so called 11Ac1-5 numbers, prove that automatic markets that are free of trade through restrictions provide investors with better results: better prices, faster executions, and fewer canceled orders.

The appropriate reform is obvious. Eliminate the ITS Trade Through Rule and allow competition to flourish as it does in the Nasdaq market. Short of full and outright repeal, Schwab proposes alternatively that the Commission first act to improve the interaction among markets trading listed securities. Then, after appropriate analysis of listed trading data, determine whether to eliminate the Trade Through Rule in its entirely.

Specifically, we believe the Commission should take the following steps:

- Investors should be given the choice to ignore slow and inefficient market centers. Therefore, we urge the Commission to support a fast market/slow market exception to the ITS Trade Through Rule. Such an exception will induce markets to implement automatic execution and automatic quote updating, thereby benefiting investors through the ensuing efficiency.

- Second, the Commission should require broker-dealers to disclose the percentage of orders executed outside the NBBO. Schwab believes that more detail regarding a fast market trading through another fast market will provide investors with the data necessary to determine the execution quality of their orders.

- Finally, Schwab believes that customers should be allowed to decide for themselves what constitutes best execution. Therefore, Schwab urges the Commission to amend the ITS Plan to include an opt-out provision so that investors, *rather than one-size-fits-all rules*, can determine how best to execute their orders.

**Market Data**

With regard to market data, Schwab believes that the current SEC proposal simply misses the real problem. Rather than treat the symptoms, the Commission should focus on reforming a monopoly based system that wildly increases the cost to investors for vital trading information.

Investors have heard lots of different stories about why market data is so expensive. We heard just two weeks ago that it costs the NYSE $488 million per year to generate market data. Strange given that, *as the Commission described in its reform proposal*, last year the Plan Networks made $424 million in revenue and incurred only $38 million in expenses. That's a monopoly mark-up of 1,000 percent. Further, Nasdaq, operator of one of the data networks, recently stated that it believes it can cut its monopoly data prices by 75% and still provide a sufficient return to its shareholders. Clearly, there is excess market data money sloshing around the exchanges, which manifests itself in everything from tape shredding, to market data rebates, to exorbitant pay packages for executives. This excess revenue is extracted from average investors who pay inflated charges to the exchange to see their own limit orders displayed.

The government-created market data cartels should be asked to justify the cost. Until there is transparency in cost and governance, the market data cartels will never change and investors will continue to subsidize markets. Schwab believes that markets should fund their regulatory and operational functions directly and transparently themselves, rather than indirectly through opaque market data charges to investors.

Schwab has three recommendations:

- First, price information relating to the NBBO based on its cost, thereby facilitating widespread availability.

- Second, simplify and standardize network accounting so that the expenses relating to market data consolidation are transparent, available to individual investors and independently audited.

- Finally, require public representation on network operating committees. A toothless advisory committee is a status quo proposal. Today, everyone acknowledges the need for independent members on the boards of public companies, mutual funds, and even SROs. Governance of market data should be no different.

**Conclusion**

In closing, Schwab commends this Committee for exercising its oversight role and examining these important issues. To sum up, Schwab hopes the SEC repeals the Trade Through Rule, or at a minimum institutes meaningful reforms, to unleash a wave of modernization in the listed market. Further, we urge the Commission to reexamine its market data proposal to end monopoly profits and ensure that all investors have access, at a reasonable price, to the most basic trading information.

Thank you again for the opportunity to testify today. I look forward to answering any questions you may have.