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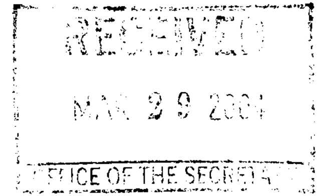


Summary of Testimony of Robert W. Seijas

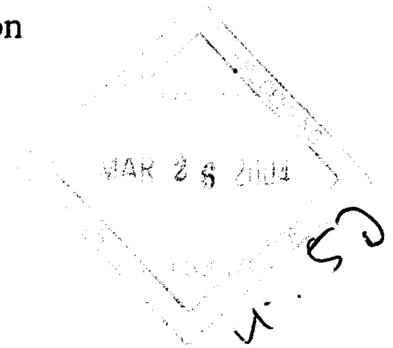
before the

Securities and Exchange Commission

concerning

Proposed Regulation NMS

(April 1, 2004)



I am Robert W. Seijas, formerly registered and acting as a specialist on the New York Stock Exchange for many years (as a partner in Lasker Stone and Stern from 1979-1991, President and later Chief Executive Officer and Chairman of Merrill Lynch Specialists from 1991-1999, and Executive Vice President of Fleet Specialists from 1999-2001). I also served as a Floor Governor of the Exchange from 1995-2001. I appear on my own behalf and on behalf of The Specialist Association, of which my former firm is a member and of which I was Co-President from 1995-2001.

Thank you for the opportunity to testify here today. I would like to state at the outset that I do not have any personal, vested interest or stake in any of the proposed market structure regulations and alternatives discussed in proposed Regulation NMS. I am recently retired and receive no financial benefit from any of the firms or entities with which I formerly was associated, from the NYSE, or from any other regulated entity that would be subject to those regulations. I do not own a seat on the Exchange or stock in any specialist firm or parent of such a firm. My interest in testifying stems solely from having spent over 40 years in the finance industry, including 33 years on the trading floor of the NYSE, both as a broker and as a specialist and my concern about the future of our markets. In my former capacities, I was involved in many aspects of market structure formulation and have a great deal of background knowledge and insight into the current issues even though I am now merely a private investor.

It is important to state up front that the trade-through debate is and has been since it started a question of self-interest and money. Simply stated, competing exchanges and market

makers have for decades been eager to divert to themselves some of the order flow that goes to the New York Stock Exchange's public auction. To these now we must add the ATSs and ECNs. Their efforts to achieve purely private ends, without regard to the public or the markets as a whole, have been unremitting and relentless, and have sometimes even flirted with impropriety. Actual cash payments for diversion of order flow, which in earlier times was called Payola, flourished until penny pricing reduced its profit potential. Similarly, internalization, by which a firm declines to expose its customers' orders to outside competitive prices until it has picked them over for its own account, continues to be a practice and an overall goal.

The bar to much of this diversion has been the SEC's insistence that the best price must prevail when trading in our markets and that the customer must have access to that best price no matter where it is found. This is a high hurdle, indeed, in the case of stocks listed on the NYSE since the Exchange offers the best price in its listed issues more than 90% of the time. Frustrated with their inability to get over this hurdle, electronic competitors, regional exchanges, and some market-making firms are eager to lower the bar or remove it entirely. They now argue that a penny or two is not meaningful, and should not prohibit them from trading away from the best price.

Five years ago, however, these same competitors were on the opposite side during the debate over decimal pricing. They argued for decimals in the belief that it would allow them to undercut the Exchange's market by a penny or two, thus forcing Exchange members to send orders to them. Some even experimented with computer programs called APIs (Automatic Price Improvement) that would track Exchange bids and offers, and automatically improve them by a penny. When The Specialist Association argued that going to pennies would allow professional traders to step in front of public orders for much too tiny a penalty, these same competitors insisted that the principle of price improvement had to remain incontrovertible, and that the order must go to the best price regardless of who was on the other side. On the record, they repeated the contention tirelessly that "For every penny you narrow spreads, you save investors a billion dollars." That argument proved persuasive to both the SEC and Congress.

Now that experience has dashed their hopes of stripping order flow away from the NYSE by out-pricing the Exchange's market, these competitors have completely flip-flopped. The billion dollars to be saved by investors has become an embarrassment. Now they now urge that a penny or two is insignificant and that we should ignore both whether best price is obtained and whether better bids and offers shown at the time a trade takes place should be filled before a trade is executed at a worse price. Unable to pass the test, they want to cancel it, and they hope that you have forgotten their earlier position and the virtues of the principles that govern trading today.

I suggest to you that the responsibility of the SEC is to protect the investor, principally the public customer. You need not worry unduly about the welfare of the major institutions of the industry. They are professionals who know very well how to further their own interests. The orders that have been and still are diverted are small retail orders entered on behalf of unsuspecting public customers. You might ask why it is that, even though the NYSE has the best price over 90% of the time, it receives only about 80% of small order trades in its stocks.

You might also ask who it is that wants to abolish or step around the trade-through rule. It is primarily the highly professional traders who make markets in options, engage in complex derivative strategies, and conduct arbitrage in multi-sided trades. These are hardly the market players most in need of SEC protection. The trade-through rule is an investor protection rule that prevents the public from being harmed by professionals' disregard of their fiduciary responsibilities and from being edged out by market power instead of best price. Price protection must remain ironclad and incontrovertible, easily understood, and not open to rationalizing or exceptions. The best price must always prevail, period.

Abolishing or watering down the trade-through rule – as would occur if the Commission were to adopt its proposed "opt-out" exception to that rule – would be the wrong solution to the professional traders' desire for more speed. The better solution is to speak directly to the specific issue, and make inter-market access faster and more efficient. The NYSE has already moved in this direction with Auto-Ex that provides nearly instantaneous reports. The newly instituted "traded ahead" key on the specialist's limit order book notifies the specialist when

someone has gotten there ahead of him. These steps deal directly with the issue without potential for public abuse – abuse that surely would flow from elimination of the trade-through rule or adoption of the "opt-out" exception. The SEC should work, as it is, to improve the means of bringing the best price to everyone effectively.

The idea that there can be exceptions to the "best price" rule through adoption of an "opt-out" provision is specious. Honest markets means completely honest, not mostly honest. Allowing some professionals to trade with other professionals at an artificial price away from better bids and offers would take a sledge hammer to market integrity and the elemental principle upon which our markets have been built. It is not just that consideration of the idea will lead to interminable debate as to who should qualify for the exception, how consent must be obtained, and open dozens of other subjective qualifications to question. The most important thing is that adopting any such concept would disadvantage and discourage public customers who currently can rest secure in the knowledge that, if they have the best bid, they will prevail. When that goes, so goes the integrity of our capital markets and the public's faith in them. To permit that to happen at the behest of professional gunslingers would be a travesty.

I would be happy to respond to any questions you may have.

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