



STATEMENT OF

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FOR THE

**UNITED STATES SENATE
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS**

HEARING ON

**CONFLICTS OF INTEREST, INVESTOR LOSS OF CONFIDENCE
AND HIGH SPEED TRADING IN THE U.S. STOCK MARKETS**

JUNE 17, 2014

I. INTRODUCTION

Good morning Chairman Levin, Ranking Member McCain, and Members of the Subcommittee. My name is Steve Quirk. I am Senior Vice President, responsible for trading at TD Ameritrade. Thank you for the opportunity to appear before you today. On behalf of TD Ameritrade, we look forward to addressing your questions on several of the many interrelated topics in the current U.S. equity market structure debate. This debate is very timely given the recent speech by Securities and Exchange Commission (“SEC”) Chair Mary Jo White, and her strong leadership and commitment to conduct a data-driven, comprehensive review of market structure.

A. TD Ameritrade Background and History

TD Ameritrade is a financial services company that specializes in serving the needs of retail investors. We offer investing and trading services to over 6 million client accounts that hold over \$600 billion in assets, including custodial services for more than 4,500 independent registered investment advisors (“RIAs”) and their clients, and provide investor education resources to investors. TD Ameritrade offers its brokerage services primarily online and over the phone, but also in person in over 100 branches located nationwide. TD Ameritrade’s corporate goal is to be the better investment firm for today’s investors.

TD Ameritrade, based in Omaha, Nebraska, was founded in 1975 and was one of the first firms to offer discounted commissions to individual investors following the passage of the Securities Acts Amendments of 1975. Since 1975, TD Ameritrade has pioneered technology changes such as touch-tone telephone trading, internet trading, and more recently, mobile trading. Each of these developments has made markets more accessible, affordable and

transparent for retail investors. For almost 40 years, TD Ameritrade has been leveling the playing field between Wall Street and Main Street investors.

TD Ameritrade is an award-winning company, and has been recognized for the quality of its trading platforms and services for retail investors:

- Barron's in 2013 and 2014 named TD Ameritrade the best online broker for long-term investing and novices. In 2012, the publication rated TD Ameritrade the best for research amenities, and research and education.
- Kiplinger's Personal Finance in 2013 named TD Ameritrade as the best broker for ETFs. In 2012, the publication named TD Ameritrade the best place for your IRA.
- Investor Business Daily in 2013 named our thinkorswim platform as the best options and mobile trading platforms.
- Stockbrokers.com named TD Ameritrade the best online broker three years in a row – 2012, 2013 and 2014.

The most important recognition, however, comes from our clients – during the last five years they have entrusted us with an additional \$192 billion in net new assets.

TD Ameritrade's business model uses open architecture and strives to provide unconflicted and unbiased products and services. When it comes to order routing, brokerage firms have two options: (1) internalize and trade against client order flow; or (2) route orders to third party market centers. TD Ameritrade believes in the current market structure, it is in the best interests of our clients to send their orders to a mix of market centers, such as wholesale market makers, exchanges and electronic communication networks ("ECNs") for execution. TD Ameritrade believes that having a diverse selection of market centers, and having them compete for our order flow is beneficial to our clients because the market centers must continually improve execution quality to be considered a viable option for executing our client orders.

Competition between markets is vitally important to the health of the current market. A few market participants or business models will not suffice. For example, it is our experience that wholesale market makers provide: consistent price improvement, fill size improvements of up to four times that quoted on exchanges, trade resolution and the ability to provide a consistent client experience. Public exchanges provide the valuable service of allowing firms to display liquidity on their depth of book; however, their model has limitations in that they do not allow for trade resolution beyond erroneous trades, do not provide fill size improvements, and, by regulation, have limited liability (*e.g.*, Facebook IPO). While the exchanges and market makers are different and serve unique roles, they are *both* vitally important in that they drive competition among market centers that ultimately benefits investors.

B. Our Clients

Our typical retail client holds on average, \$81,000 of assets with us. This client is 49 years old and places 24 trades annually. Our clients have access to the markets today that only professionals used to have in the past. They have access to free independent research reports on our website, investor education courses, and real-time streaming quotations. They use our powerful trading software, and they receive split second executions, most of the time, with price improvement.

We believe that the current U.S. equity structure has never been better for retail investors.

Our retail clients generally want the following:

1. **Inexpensive execution.** Retail online discount commission rates have been reduced by almost 70% since 1997 – from an average of \$38.63 to \$12.03 per trade.
2. **Orders filled quickly.** Our average execution speed has improved by 90% since 2004 – from 7 seconds to 0.7 seconds today.

3. The price that they are quoted, or better. In 2013, our clients trading listed securities received a better price than the published national best price 91% of the time – ten years ago, the industry average for marketable orders in listed stocks was 14%.
4. Their entire order filled. Approximately 99% of client market orders are filled in their entirety. In our experience, the wholesale market makers provide an average of four times the liquidity that is available on the exchange displaying the largest amount available.

Our data shows that during the past year, the retail investor has re-engaged with the stock market, and with renewed faith. The number of TD Ameritrade accounts trading is up 31% year over year.

Retail investors today benefit from competition in the marketplace, just as they benefit from competition among brokerage firms. TD Ameritrade provides clients with an all-inclusive experience where we charge a fixed transaction fee inclusive of streaming tools, free market data, 24-hour client support, research and education, all at no additional cost. Other brokerage firms offer a more “à la carte” approach and charge a separate fee for each service (*e.g.*, fees for real-time market data), but may pass through to clients certain economics, such as market center rebates. Many of the firms in our space utilize an “all in” model. We believe our offering provides value and is aligned with what our clients generally want.

II. CONFLICTS OF INTEREST AND BEST EXECUTION

Today’s hearing focuses on a few components of the larger market structure debate. The Subcommittee asked TD Ameritrade its views on possible conflicts of interest as they relate to a brokers’ obligation to seek best execution for their client orders and, at the same time, receive payments or rebates based on where their order flow is directed. Conflicts of interest are common throughout the financial services industry, but TD Ameritrade believes that a broker’s compliance with its best execution obligations, along with proper disclosure, can allow the

broker to effectively manage any conflict of interest that may arise by accepting payments or rebates. We strongly believe that we effectively manage any such conflict.

A broker's duty of best execution is well established. When handling customer orders, brokers are required to seek the most favorable terms reasonably available under the circumstances. We consider many factors in making this assessment, including, the opportunity to obtain a better price than currently quoted, the speed of execution and the likelihood of execution.

In fact, this is how our order routing strategy works:

- First, we give our clients choice. They can choose to route their orders using TD Ameritrade's order routing logic, or they can choose from a list of direct routing destinations.
- Second, we do not internalize orders. We believe that turning all client orders back to the market is more transparent and better aligned with the needs of our clients.
- Instead, we work with multiple market centers, which are selected after extensive due diligence where execution quality is a top priority, in addition to a litany of other variables such as system capacity and performance, order handling protocols, risk controls, capitalization and business continuity procedures.
- And third, we evaluate market center stability, execution quality and consistency every day. We hold our market centers to a very high standard, and in the event that there is a degradation, we adjust accordingly.

After, and only after a market center satisfies our standards for providing best execution, do we consider transaction costs or revenue opportunities. Regardless, the payments we receive from market participants do not interfere with our efforts to seek quality execution and optimize the value proposition for our clients. Best execution comes first.

Transparency also is important in addressing conflicts. The payments or rebates that brokers receive are disclosed as an average per share payment in the quarterly Rule 606 reports,

which the SEC requires brokers to post on their websites. Clients also are informed that we receive payment for order flow in their account agreement, on account statements and on confirmations, as required by SEC rules.

The recent Battalio study raises questions whether the receipt of maker-taker fees paid by exchanges could interfere with a broker's pursuit of best execution of client limit orders. As we understand, the study remains in draft and is subject to peer review. And, we understand that at least one academician has raised questions regarding the relevance of the data and the conclusions that are drawn from the data. From our perspective, we will simply note that the draft study used two months of data consisting of "*non-retail* order flow from one broker trading algorithm," and we question whether it is appropriate to draw any conclusions about the execution quality of *retail* order flow, which appears to us to be fundamentally different from the order flow that was analyzed.

Revenue generated from order flow is used to operate our business and is indirectly passed back to clients in part through the products and services that TD Ameritrade offers at low or no additional cost. As noted earlier, TD Ameritrade clients enjoy: free trading software; free real-time market data; and free independent research, to name a few products. That is, clients benefit tremendously from market access that remains easy and inexpensive. TD Ameritrade agrees with the primary author of the draft study when he states that payment for order flow "appears to be beneficial for investors... because payments for order flow are passed back to investors due to brokerage house competition."¹

¹ DOES PAYMENT FOR ORDER FLOW TO YOUR BROKER HELP OR HURT YOU? Robert H. Battalio and Tim Loughran, at page 14 (January 17, 2007). *See also* DIMENSIONS OF BEST EXECUTION FOR MARKET ORDERS: ASSESSING DIFFERENCES BETWEEN THE NYSE AND THE NASDAQ THIRD MARKET, Robert

III. RECOMMENDATIONS

The Subcommittee asked whether TD Ameritrade has recommendations for policies that could reduce or eliminate conflicts of interest while maintaining liquidity and low investor costs, and enhancing public confidence in the U.S. equity markets. As noted above, TD Ameritrade, agrees that retail investors have never had better, low cost access to the markets. And, we believe the pursuit of best execution and disclosures can effectively manage conflicts of interest related to a firm's receipt of payments or rebates. Clearly, any market structure changes should first "do no harm" to investor costs or access. That being said, we agree that the markets are not perfect, and we should always be looking for ways to improve them. TD Ameritrade has the following recommendations:

- We applaud SEC Chair White's recent speech announcing the wide-ranging market structure proposals now being considered by the SEC staff. We believe it is appropriate for the SEC to consider the topics discussed today in the context of the SEC's holistic review of market structure.
- Equal and timely access to information.
- Update and improve the Rule 605 and 606 statistics.
- Increase technology resiliency and redundancy.
- Continue to enhance transparency.

Battalio, Brian Hatch and Robert Jennings, at page 20 (March 2000) ("payment for order and high quality trade executions are not necessarily mutually exclusive."); PAYMENT FOR ORDER FLOW, TRADING COSTS, AND DEALER REVENUE FOR MARKET ORDERS AT KNIGHT SECURITIES, L.P., at page 4 (December 1998)("We find little evidence that investors using brokers accepting payment for flow are worse-off than investors using a broker that does not."); TO PAY OR BE PAID? THE IMPACT OF TAKER FEES AND ORDER FLOW INDUCEMENTS ON TRADING COSTS IN U.S. OPTIONS MARKETS, Robert Battalio, Andriy Shkilko and Robert Van Ness, at page 36 (Nov. 3, 2011)("requiring brokers to explicitly pass taker fees and order inducement fees back to investors on a trade-by-trade basis is a potentially costly cure for an ailment that may not exist.")

IV. CONCLUSION

The U.S. capital markets are the most accessible, diverse, liquid and transparent in the world. Great care should be taken before making even small changes that could have large, unintended consequences. Moreover, any review of market structure should be undertaken in a holistic way, based on relevant and objective data and a deep understanding of the markets. TD Ameritrade believes that the continual pursuit of best execution and disclosure effectively manage any conflicts of interest presented by revenue sharing arrangements. As we have said before, our view is that execution quality for retail investors has never been better. Costs are lower than ever, spreads have narrowed significantly, liquidity has increased, and execution speed has improved. Just as we are constantly seeking to improve our client experience, we as an industry should continue to examine ways in which we can improve our nation's market structure – without compromising the many improvements that currently exist.

TD Ameritrade looks forward to participating in a thoughtful review of our current market structure, and appreciates the opportunity to appear before the Subcommittee to contribute constructively to this important debate. I am happy to address any of your questions.