Opening Statement of Senator John McCain
Before
Permanent Subcommittee on Investigations
On
Conflicts of Interest, Investor Loss of Confidence, and
High Speed Trading in U.S. Stock Markets
June 17, 2014

Thank you, Mr. Chairman. When Michael Lewis's book *Flash Boys* came out, the public knew very little about high-frequency trading. Important questions were raised: Is the stock market, quote, "rigged" by unethical high-speed traders with faster access to market information, advanced technology, and sophisticated trading algorithms? Is high-frequency trading adding costs for other traders without contributing any real value to the market? Will stock markets face another flash crash like in 2010 when the Dow Jones temporarily lost $1 trillion dollars in market value in 20 minutes?

These concerns about high-frequency trading have fueled suspicions that Wall Street may well have become the ultimate insiders' game, where the average investor can no longer meaningfully participate. Consumers see firms that can make trades in fractions of a second using cutting-edge technology and wonder if the stock exchanges are still a place where their interests matter. Hopefully, this hearing will shed light on the high-frequency trading practices used on Wall Street and help restore confidence in our financial system.

The Subcommittee interviewed many industry participants, academic researchers, and key financial regulators. While the problems facing the market are complex, we can address them with a few common sense solutions. For example, one of the most predatory high-frequency trading practices depends on the unintended consequences of the SEC's Regulation National Market System, or Reg NMS. That regulation essentially mandated that investment firms must buy or sell stocks at the best price available. While that might sound like a reasonable requirement, high-frequency trading firms can take advantage of the rule by putting out offers to buy or sell small amounts of stock at attractive prices. When a large investor, seeking to make a big order, accepts the high-frequency trading firm's offer because it is the best price available, the high-frequency trader can predict that the large investor will have to go to another exchange to purchase the rest of his order. The high-frequency trader can then race ahead of that investor to the other exchanges, buy up all available shares, and sell them to the large investor at a higher price. Changing Reg NMS so that investment firms are no longer

legally required to take the high-frequency traders' bait is an easy, clear first step to cleaning up the worst high-frequency trading practices.

Another key tactic used by high-frequency trading firms is co-location. This practice involves trading firms literally renting space for their computers in the same room as the computers that run the stock exchanges so that they can receive market information directly from the exchanges' computers as fast as possible. The investors that don't buy this direct connection to the exchanges receive market data via a government-established system using out-of-date technology called the Securities Information Processor that compiles market data much more slowly. But, as experts told the Subcommittee, there is no reason why public data feeds like the Securities Information Processor cannot be improved so that they are effectively as fast as private data feeds acquired through co-location. Updating the technology in the Securities Information Processor is another helpful measure that can be quickly adopted to shore up consumer confidence in the market.

In addition to high-frequency trading, *Flash Boys* also described how stock exchanges often pay rebates to stock brokers to entice them to trade on those exchanges. Those rebates, called "maker-taker payments," create an apparent conflict of interest for the stock brokers, who must choose between sending their clients' orders to exchanges offering a higher rebate or to exchanges that would fill the orders as quickly as possible. While many trading firms argue that those payments spur more market activity and reduce costs for consumers, some experts have argued that these benefits are minimal and that investors are harmed by their brokers' conflict of interest.

The Subcommittee has found that there is a lack of publicly-available data regarding maker-taker payments, leading to difficulties in determining whether the payments actually have an adverse effect on the market. A logical first step would be to have more transparency in the payments, allowing neutral researchers to study the issue in greater detail.

I hope that this hearing will educate the public about high-frequency trading and broker conflicts of interest, and I look forward to hearing what the witnesses have to say. Thank you, Mr. Chairman.