



**Market Structure Roundtable
Securities and Exchange Commission
June 2, 2010**

WRITTEN STATEMENT OF:

**Daniel Mathisson
Managing Director
Credit Suisse**

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Introduction

Good afternoon, and thank you for giving me the opportunity to share my views on the best structure for our nation's stock markets. My name is Dan Mathisson, and I am a Managing Director and the Head of Advanced Execution Services for Credit Suisse¹.

The U.S. broker-dealer subsidiary of Credit Suisse Group has been operating continuously in the United States since 1932, when the First Boston Corporation was founded. Today, Credit Suisse is the market share leader in electronic trading², and Credit Suisse owns and operates Crossfinder, the largest Alternative Trading System (ATS) by volume.³

Advanced Execution Services ("AES") is a team of approximately 200 financial and technology professionals based in New York that executes trades electronically on behalf of mutual funds, pension funds, hedge funds, and other broker-dealers. The AES group does not engage in proprietary or risk trading. 100% of our revenue comes from institutional client commissions, and therefore our success depends on our ability to minimize our client's transaction costs while providing safe and reliable trading systems.

I have been managing the AES group at Credit Suisse since founding it in 2001. Prior to that, I traded stocks for eight years for a New York investment firm called DE Shaw & Co. In addition to my role at Credit Suisse, I am presently on the Board of Directors for the BATS Exchange based in Kansas City, and I am a regular columnist for Traders Magazine, where I write about market structure issues. I appreciate the chance to appear here today representing Credit Suisse.

Background

With the implementation of Regulation ATS in 1998, the Commission embraced competition of market centers as one of the hallmarks of U.S. market structure. This was an innovative and daring move at a time when every other developed financial market in the world had an exclusive national exchange monopoly model. Regulation ATS radically departed from this model, based on the economic principle that multiple trading venues would lead to the benefits of competition seen in other industries: lower

¹ Credit Suisse provides its clients with private banking, investment banking and asset management services worldwide. Credit Suisse offers advisory services, comprehensive solutions and innovative products to companies, institutional clients and high-net-worth private clients globally, as well as retail clients in Switzerland. Credit Suisse is active in over 50 countries and employs approximately 47,400 people. Credit Suisse is comprised of a number of legal entities around the world and is headquartered in Zurich. The registered shares (CSGN) of Credit Suisse's parent company, Credit Suisse Group AG, are listed in Switzerland and, in the form of American Depositary Shares (CS), in New York. Further information about Credit Suisse can be found at www.credit-suisse.com.

² Greenwich Survey, April 2010, Tabb Report, October 2009

³ Rosenblatt Survey, April 2010

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costs, innovative products, and better client service. Regulation NMS, which went into effect in 2007, built further on this competitive approach.

Twelve years into this experiment, it cannot be called anything other than a complete success. Exactly as intended, Regulation ATS and Regulation NMS fostered a marketplace with many trading venues engaged in a vibrant and healthy competition. Despite initial fears that fragmentation would create chaos, the consolidated tape and the creation of smart order routing systems have effectively stitched all these market centers together into a true national market system. For the typical investor, the presence of all these venues remains behind-the-scenes and opaque, but they have certainly benefited from the decrease in their commissions as well as the improvements in bid/ask spreads, speed of execution, reliability, and service.

The numbers tell the story. Bid/ask spreads in the U.S. are currently the tightest in the developed world, benefiting retail investors.⁴ Retail commissions are the lowest they have ever been, while average institutional commissions have dropped 65% since 1998, and 31% since 2006.⁵ As trading costs have dropped due to competition among executing venues, volume has dramatically risen.

Volume is the most important measure of a market's health. When a market is corrupt, expensive, or unreliable, investors avoid the marketplace. In markets that are fair, low cost, and reliable, trading volume is high, because investors have confidence in the marketplace. High volumes and large numbers of investors lead to efficient price discovery, and equally important, they provide the assurance that investors will be able to liquidate a stock when they need cash. It is that promise of future liquidity - provided by healthy secondary trading activity - that allows companies to raise capital through equity offerings.

In short, volume is the lifeblood of the markets, and high volume is a sign that regulators are doing something right. And volume has grown materially since Regulation ATS and Regulation NMS. In 1997, the year before Regulation ATS was launched, average daily U.S. equity volumes stood at 1.2 billion shares per day. By 2006, the year before Regulation NMS was fully launched, volume had quadrupled to 4.8 billion shares per day. Post-Regulation NMS, volume continued to increase, growing to a healthy 9.5 billion shares per day in the first five months of 2010, which is a tremendous affirmation of the efficiency and fairness of the existing U.S. market structure.⁶

⁴ U.S. bid/ask spreads were tightest in a study of major markets based on the 1st quarter of 2010. Source: Credit Suisse AES Analysis.

⁵ Tabb Group, Credit Suisse Research

⁶ Source: Bloomberg Data

The Benefits of Dark Liquidity

Although still a niche product, a percentage of this healthy volume has been “dark” order types that do not display on the public quote. Institutional traders, who collectively invest the savings of millions of Americans, expend a great deal of effort finding ways to buy and sell large amounts of stock in a manner that will not adversely move stock prices and hurt their investors. To accomplish this, traders have always used a variety of trading techniques, including the use of “dark” liquidity.

Dark orders are not a new phenomena. Before computerized dark pools existed, traders still often chose to keep their bids and offers undisplayed. In the old days, this was accomplished by giving a “not-held” order to a floor broker on the exchange, who would then keep sensitive orders “in his pocket.” The broker would literally drop the order ticket in his pocket, without displaying it to the world, while keeping his eyes and ears open for the other side of the trade. This process also occurred at the specialist post on the exchanges, and in the “upstairs” market, where brokers would hold client orders while looking for the other side.

Dark pools, and dark order types on exchanges, simply automate this ancient process. Traders drop orders into the computer’s “pocket.” The computer, just like the floor broker of old, does not tell anyone about the order. If the other side of the trade happens to also drop into the dark pool or the exchange, the computer matches the two orders, and a trade occurs.

Computerized dark pools have been around for more than 25 years, and exchanges have offered dark order types since 2006. Today, dark order types are an integral part of the trading ecosystem, and they exist because they fill a need: the need for an investor to be able to trade without signaling to the entire world that a new buyer or seller has entered the marketplace. Dark order types are a positive presence that reduce transaction costs for firms that trade market-moving size, such as mutual funds and pension funds.

Price Discovery

Critics of dark liquidity have suggested that dark order types have damaged the amount of size displayed on the National Best Bid Offer (the “NBBO”). Empirical evidence indicates this is not the case. Although dark pool volumes have steadily grown over the past decade, peaking at their current level of approximately 10% of all market volume⁷, a Credit Suisse study found that displayed size has actually increased 72% since 2004.⁸ The empirical evidence does not reveal a problem of bid/ask sizes shrinking.

⁷ Rosenblatt Securities Inc. Market Structure Analysis and Trading Talk, March 24, 2010

⁸ Credit Suisse studied the median quoted size in all stocks in the Dow Jones Industrial Average. Every tick was included from August 2004 through March 2010. We found the median displayed size on the NBBO was 5500

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Also worth noting is that dark pools must report all trades to the public tape immediately, and their real-time prints are a valuable source of “last trade” data, clearly aiding the public in pricing stocks.

Trade-At Rule

As already discussed, Regulation ATS and Regulation NMS have been tremendously successful, creating a vibrant and healthy competition for order flow that has led to high volumes and the tightest bid/ask spreads in the world. Credit Suisse believes that the “Trade-at” rule that is discussed in the concept release would reverse some of these gains. A trade-at rule would damage competition among exchanges and ATSs, and therefore drive exchange fees higher. It might also lead to some unintended consequences, including an increase in retail commissions, a decrease in the average print size, and more flickering quotes.

The existing system wisely does not allow “trade-throughs,” e.g., a broker-dealer is not allowed to buy stock for his client at 20.64 on an ATS if there is an outstanding offer at 20.63 displayed on the quote. The trade-through rule promotes fairness and encourages competition by assuring clients that orders displayed on smaller exchanges or ECNs get the same protection as orders on larger exchanges.

But a key aspect of the current system is that at any given price point, all venues are considered equal, and the broker-dealer is empowered with the right to choose which venue will achieve best execution for his client. Although all venues are considered equal, not all executions at the same price are equal: at a given price, brokers may still prefer one venue over another based on reliability, speed of execution, access fee, customer service, average trade size, or other factors. It is this freedom of choice that has put exchanges in constant competition with ATSs and over-the-counter (“OTC”) market makers, resulting in the exchanges’ dramatic improvements in recent years in fees, speed, reliability, and customer service.

Requiring broker-dealers to sweep displayed offers at a given price point before taking dark ATS liquidity would drive costs for institutional investors significantly higher. For example, the “take” fee on displayed Nasdaq liquidity is 0.3 cents per share. On Level ATS, which does not display liquidity, the “take” fee is only 0.05 cents per share. Under a trade-at rule, if Level ATS matched two brokers, and Nasdaq happened to be offering stock at the same price, Level ATS would need to take Nasdaq’s offer first, ultimately raising the buyer’s costs by 0.25 cents per share.

The Commission recognized in the concept release that a trade-at rule would need to take access fees into account, and suggests that a possible solution would be to allow

shares in the 1st quarter of 2010, up from 3200 in 2004. See Avramovic, Ana, “Sizing Up US Equity Microstructure”, Credit Suisse AES Analysis, April 22, 2010.

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market centers to “opt-in” to trade-at protection. The Commission would restrict any market centers who want trade-at protection to charging a de minimus access fee. However, this would not solve most of the problems presented by a trade-at rule. Even a de minimus access fee, say .02 cents per share, may impose a considerably higher cost than trading with an OTC market maker who currently rebates for market orders. Furthermore, such a rule would interfere with a broker’s ability, consistent with best execution, to take into account factors such as speed, reliability, and customer service. This ‘opt-in’ mechanism would not solve the fundamental problem of a trade-at rule: that it would remove competitive pressures from the marketplace.

Under any form of trade-at rule, retail investors would likely see an increase in their costs, and a reduction in their quality of execution. In the current system, most retail orders are sent to OTC market makers rather than exchanges or ATSS. These market makers typically pay rebates to the retail broker, and provide better quality of execution than exchanges, as evidenced by the Commission’s Rule 605 statistics. OTC market makers provide price improvement on retail orders, and they also turn order execution into a source of revenue for retail brokers, which in turn allows retail brokers to charge very low commissions to their customers.

If a trade-at rule was implemented, retail brokers would be required to route marketable orders to displayed markets. Routing orders to displayed markets would prevent the current standard practice of market makers providing guaranteed price improvement and enhanced liquidity to retail investors, and would therefore result in worse pricing for the retail orders. It would also force market makers to incur access costs which would almost certainly be transferred to retail customers in the form of higher commissions. The retail investor is well-served by the current system: immediate execution, typical price improvement, the tightest bid/ask spreads in the world, and very low commissions. This system would be negatively impacted under a trade-at rule.

Trade-at may also have other unintended consequences, such as further decreasing the average size of an executed order in the U.S. and increasing flickering quotes. Block prints done by “upstairs” brokers or computerized ATSS would often get broken up, reducing the size of the blocks. More significantly, even if fill rates dropped on undisplayed venues, it is highly unlikely that institutional investors would transfer their orders to displayed venues. For example, a pension fund manager who today offers 200,000 shares in a dark pool pegged to the national best offer would not show that order publicly under a trade-at rule. If fill rates on dark pools decrease due to a trade-at rule, the pension fund manager would be more likely to respond by using broker algorithms to slice the large “parent” order and place a series of tiny pieces spread out across multiple ECNs and exchanges, with the thousands of resulting “child” orders being cancelled and replaced based on expected fill rates, quote moves, and other factors. The result would be smaller average print size, greater quote traffic, and an increase in flickering quotes.

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Overall, we believe that trade-at in any form is a dangerous change that would damage the U.S. markets by curtailing the incentive for market centers to innovate and compete for order flow. Tinkering with the markets in this manner should only be done if the Commission has significant empirical evidence that public price discovery has been harmed by the existing rule, and evidence that a trade-at rule would significantly improve the quality of displayed quotes. We know of no such evidence. The trade-at rule appears to be a solution in need of a problem.

Fair Access to ATSS Based on Objective Criteria

Although Regulation ATS has been a tremendous success, it is not perfect. Brokers and investors searching for dark liquidity in the current market structure can be denied access to an ATS for anti-competitive or capricious reasons. Those who are against fair access typically argue that ATS operators should be allowed to protect their clients from trading with particular classes of traders. In response to this concern, we note that the current fair access rule, Rule 301(b)(5), allows ATSS that cross the triggering threshold to deny access – they just must document why they denied access, and the denial must be based on objective criteria in a non-discriminatory way.

The structure of the current fair access rule is also problematic. Credit Suisse has long argued that applying these thresholds on a stock-by-stock basis is not practical or wise, and serves to undermine the intent of the rule. Brokers will not bother to connect to an ATS for just one stock. A significant investment in time and resources is required to negotiate an agreement, run a connection, and set up and test trading and clearing with an ATS. It is almost never going to be worth the cost to connect to an ATS for access to a single stock. The solution is simple: eliminate the concept of a threshold, and force all ATSS to create objective criteria for access and document denial of access.

Note that we do not support a lower threshold – only a complete elimination. A lower threshold of say, 1% of volume, would only serve to create odd incentives to split ATSS into multiple smaller ones, or to shut down trading once the threshold is approached.

Conclusion

Credit Suisse believes that markets work best when there is a vibrant competition among numerous types of trading centers, with all investors given an equal opportunity to access all of them. With a diverse mosaic of exchanges, ECNs, ATSS, and OTC market makers all competing with each other for order flow, the investor inevitably wins, as competition drives lower fees, innovative products, and improvements in reliability, speed, and customer service.

Our embrace of competitive market centers is the overriding philosophy that drives our market structure opinions. In summary, we believe:

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- ATNs are beneficial because they create competition for exchanges.
- Dark pools create a competitive marketplace for orders that would otherwise still be sitting in a floor broker's pocket.
- The fair access requirement in Regulation ATN hurts competition and therefore should be updated.
- The "Trade-at" rule is a bad idea, because it would decrease competition and therefore ultimately raise investor expenses.

Thank you for the opportunity to appear today, and I will be happy to answer any questions that you may have.