

Comments on Greenwich Associates' Survey

Kenneth Lehn

University of Pittsburgh

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“I guess I sum up the answer as to why we have ECNs as the fact that the national stock exchanges and I’m not only talking about ours, but the exchanges around the world haven’t been keeping pace with the needs of the market.”

Frank Zarb, then-Chairman, NASD

Senate Banking Committee Testimony

October 1999

Greenwich Associates Survey

Good news for ECNs

1. ECNs trump NYSE on

Anonymity

Speed of execution

Market impact

2. respondents believe specialists add no value in liquid stocks, e.g., IBM

and that proprietary trading by specialists constitutes a conflict

3. almost one-half of respondents want to trade more away from the exchange floor

GA Study is Consistent with Academic Evidence

Execution costs are lower for ECN trades than for broker filled orders

Domowitz and Steil (1999)

Barclay, Hendershott, and McCormick (2002)

Conrad, Johnson, and Wahal (2003)

ECNs contribute to price discovery

For liquid Nasdaq stocks

Huang (2002)

For ETFs

Hendershott and Jones (2003)

Will Focus my Comments on Two Areas

The Greenwich Associates Study

Its implications for the NYSE and regulators

Comment # 1 on Greenwich Associates Survey

Is the sample representative of all institutional investors?

Many large institutional investors are missing from the survey:

American Funds
Delaware Investments
Dreyfus
Lord Abbett
Nuveen
Oppenheimer
Pioneer
Putnam
Scudder
State Street
Vanguard

Is there a potential selection bias? Perhaps in favor of ECNs?

Comment # 2 on Greenwich Associates Survey

Are the responses different for different subsamples of institutional investors?

large v. small institutions

value-weight the responses?

actively managed v. index funds

large cap v. small cap (and mid cap)

Do different types of funds want different things from a trading system?

Comment # 3 on Greenwich Associates Survey

It would be useful to ask a few more questions.

Which marketplaces do the best job of executing “hard” trades requiring large capital commitments?

Which marketplaces do the best job of handling trades during stressful periods, e.g., around 9/11?

Has decimalization made it more attractive to trade on ECNs?

And, more questions on the price discovery performance of the different marketplaces.

Implications for NYSE

Raison d'être of specialists for some transactions is eroding

But we shouldn't exaggerate problems at NYSE

Academic evidence

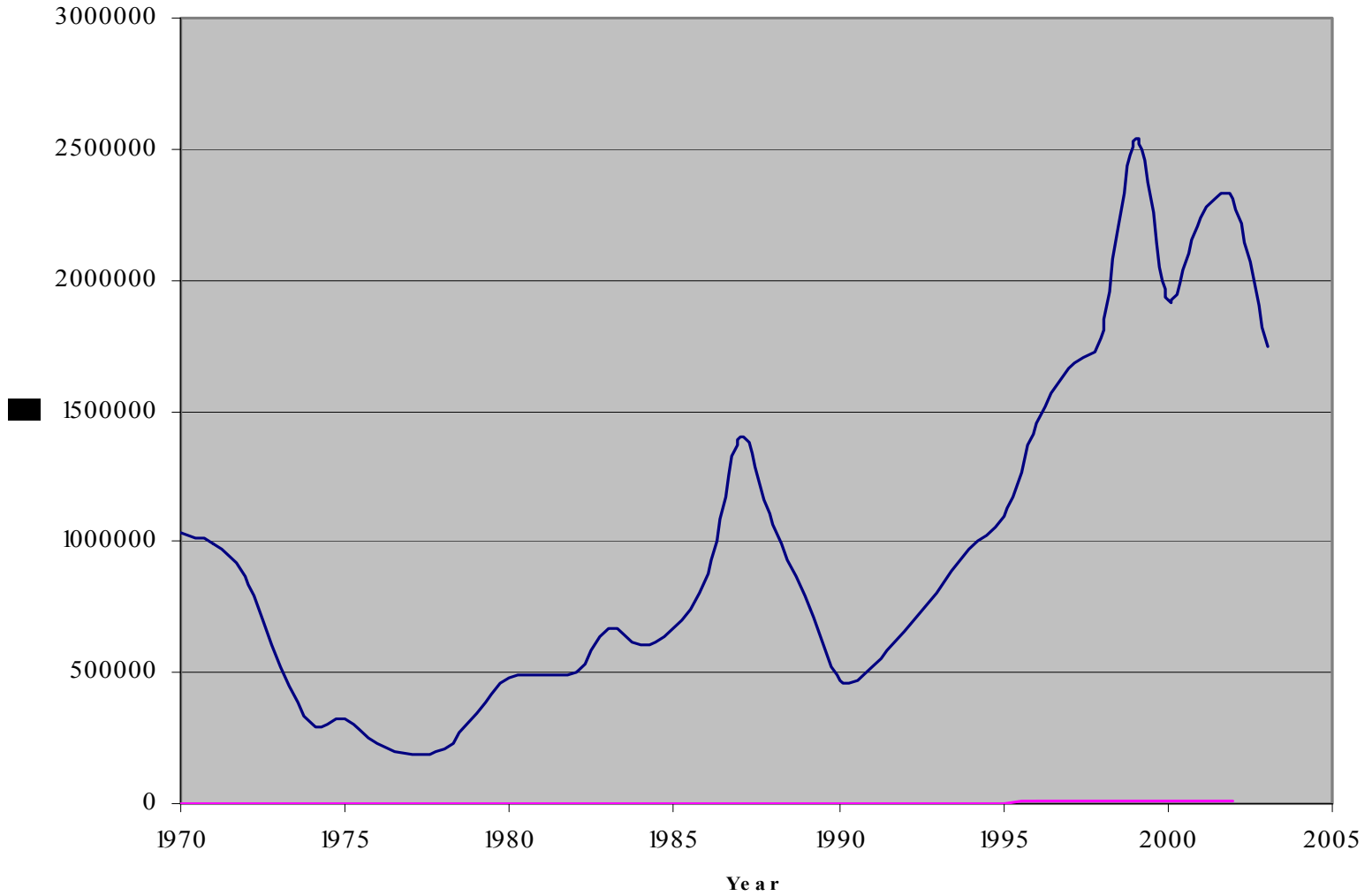
it does well in terms of both execution costs and price discovery (e.g., Hasbrouck (1995) Huang and Stoll (1996), Laplante & Muscarella (1997), Bessembinder (1999), Heidle and Huang (1999), Boehmer (2003), Bennett and Wei (2003))

Still accounts for bulk of the order flow in listed stocks

It has advantage in price discovery

Seat prices have increased with growth of ECNs

NYSE Seat Prices Adjusted for Inflation, 1970-2003



NYSE's Main Challenge

It needs to adapt more effectively to changes in technology, customer demand

Otherwise, it could become a “dinosaur”

Governance reforms should help it become more nimble, less bureaucratic

Conversion to for profit status with transferable shares would help

Subject to shareholder monitoring

Discipline of corporate control market

Smaller board as Reed advocates

NYSE board has 24 directors

Instinet has 8 directors

Instinet is much more nimble

Implications for Regulators

Avoid “one size fits all” approach to market structure regulation

different business models serve different clienteles

Don't focus on trading costs to the detriment of price discovery

Enable NYSE to transition to more nimble governance structure

too much micromanagement of exchange procedures by SEC, which inhibits ability of exchanges to react quickly in rapidly changing environment

focus more on enforcement of rules rather than regulation of procedures

Revisit the issue of decimalization – has it done more harm than good?