

AKRON BEACON JOURNAL

Silvio Laccetti: The 'Flash Boys' Take on Wall Street

APRIL 8, 2014
BY SILVIO LACCETTI



TWO YEARS ago, protesters were occupying Wall Street. Today, according to the new book “Flash Boys” by Michael Lewis, we have an occupation conducted by a group of techies who somehow found each other and declared war on Wall Street. These “flash boys” have a more limited agenda than Occupy Wall Street’s, but still one that encompasses a fundamental theme: to root out shady practices that may harm the American public.

The “boys” have targeted the enablers (big brokers and exchanges) of predatory forms of HFT — high frequency trading — in an effort to help retail investors. These include individuals who hold equities in IRAs, 401(k)s, pension plans, 529s, etc. The “flash boys” and others contend that billions of dollars annually are being unnecessarily transferred from investors to the fastest HFT firms and the exchanges and broker-dealers who support them.

So what’s wrong with this? Plenty!

In one predatory HFT strategy, through the use of ultra-sophisticated technology and mathematical modeling, the traders are able to detect the imminent presence of large stock orders (yours and others bundled together) in the marketplace before they are fully executed. These predators can then buy/sell ahead of the order, often by milliseconds, skimming a profit of as much as pennies per share.

Adding up to billions

When summed over billions of individual trades per year, and with HFT being an estimated 50 percent of daily volume, this strategy (and others) can add up to billions of dollars in profits.

But there is more behind this phenomenon. To see a full picture, I turn to discussions I had with one of the “flash boys” whom I had the pleasure of teaching and employing in my research when he was a student at Stevens Institute of Technology.

John Schwall made an immediate impression on me. I realized, before he did, the tremendous transformative potential he could bring to any situation. After a rocky start at Stevens, he eventually became — as I dubbed him — the President of all Presidents. That is, he was president of just about every important student group on campus.

In the book, he is portrayed as a patriotic member of the “geek squad” — perhaps a misnomer for a guy who was once a New York City wrestling champion.

John was affected deeply by 9/11. Thereafter, he saw his work at Bank of America as a quasi-sacred trust. That changed after he witnessed how Merrill Lynch’s trading in questionable housing loans led to its near collapse. Merrill Lynch was saved by Bank of America, which received U.S. government bailout money to prevent its own collapse.

Most frustrating to John in this scenario was that Merrill Lynch executives, after their rescue and with intimate knowledge of the firm’s demise, still awarded themselves record bonuses.

That outrage resulted in an epiphany for Schwall, and he made up his mind to do all he could to clean up Wall Street.

Hence, the creation of a new exchange that he and his fellow “flash boys” have designed. This marketplace, IEX, aims to neutralize predatory HFT practices by placing all market participants on equal footing for trades executed at the most current stock prices.

Moreover, IEX aspires to set the highest standard of trust in financial services.

I called John recently, in the wake of the Lewis book release and the ensuing media frenzy, and he explained how the company has received thousands of phone calls and emails from people throughout the country, many just to say “Thank you.”

Many are taking notice. Wall Street firms such as Goldman Sachs have publicly called for change, including an endorsement for IEX.

Federal and state authorities, including the SEC, the Justice Department, the FBI and the New York attorney general’s office are said to be investigating or starting to investigate the HFT phenomenon.

A shift in values

IEX’s success may result in a shift in values of American culture and education. Over the past decade or more, financial firms infamously created destructive financial products while at the same time they devised complex HFT algorithms designed to profit from equity market inefficiencies. There’s no added social value in this work.

It is done by some of America’s brightest graduates in physics, mathematics, computer science and engineering. These minds could otherwise engage in solving real social problems. I know this as well as anyone. I taught these types of students throughout my entire career.

I am pleased that John is leading a public-minded charge for change on Wall Street. My hope is that we find more great, young minds to tackle serious problems in all areas of American life.

Silvio Laccetti is a retired professor of social sciences at Stevens Institute of Technology and a national columnist. His collected editorials appear in the new book, “An American Commentary,” available from qjbooks.com