Report to the SEC Advisory Committee on Market Information
Re: Securities Exchange Act Release No. 34-42208; File No. S7-28-99

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Executive Summary

Information is the lifeblood of a financial market and the procedures for collecting and disseminating information have a direct impact on the public's trust and confidence in the financial system. The importance of market information was stated elegantly by the Securities and Exchange Commission (the "Commission") when it noted that a "consolidated, real-time stream of market information has been an essential element in the success of the U.S. securities markets. It is the principal tool for enhancing the transparency of the buying and selling interest in a security, for addressing the fragmentation of the buying and selling interest among different market centers, and for facilitating the best execution of customers' orders by their broker-dealers."[1] This sentiment was echoed by the Securities Industry Association (SIA) which commented that "access to quality data and its cost are critical to SIA's member firms and their

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[1] SEC Concept Release: Regulation of Market Information Fees and Revenues, Release No. 34-4228, File No. S7-28-99, p. 4.

customers. Transparent markets are essential to maintaining the public's trust and confidence in our capital markets."[2]

The SEC Advisory Committee on Market Information (the "Committee") has been given the charge of reviewing the current arrangements for disseminating market information to the public and, if needed, proposing change. Considering the stakes involved, and the direct impact of these procedures on interested parties, it is not surprising that the Committee has received a variety of proposals for radical change. The message of this report, however, is to urge the Committee and the Commission not to abandon a structure for disseminating market information that has worked well for more than 25 years under extremely diverse and rapidly changing market conditions. Some changes to the existing regulatory structure may be necessary and appropriate at this time. However, the unintended consequences of radical change have the potential to harm the interests of investors and could seriously impair the functioning of our financial markets.

The report that follows makes five basic points that are summarized below:

- The availability of consolidated, real-time market information is the cornerstone of our national market system and is essential to achieve the goals of transparency, fair competition between market centers, and best execution. Any change in the regulation of market-information fees and revenues that jeopardizes investors' access to fully consolidated market information would hurt investors and impair the integrity of our financial markets.
- The existing national market plans have relied on an exclusive securities information processors (SIP) to collect bid and ask quotations and last sale reports from the various market centers and to consolidate and transmit this information to vendors and subscribers. The use of an exclusive information processor is an efficient mechanism for accomplishing this task that has worked reliably for more than 25 years under extremely diverse and rapidly changing market conditions. Changing this structure under the guise of increasing competition could generate unintended consequences that are not in the interests of investors.
- Greater competition for the position of exclusive information processor, and among downstream information vendors, can be achieved within the current regulatory structure. This increased competition can be harnessed to reduce costs and stimulate innovation and product improvement.
- The governance structure of the existing national market plans should be expanded to include a broader spectrum of the investment community.

[2] Comments of Marc E. Lackritz, Re: Securities and Exchange Act Release No. 42208, File No. S7-28-99, April 11, 2000. (http://www.sec.gov/rules/concept/s72899/lackrit1.htm).

Dissatisfaction with the level or administrative structure of market-information fees or concerns about the quality of the information product can be addressed through this broader governance structure.

- The SEC Advisory Committee on Market Information should consider changes to the current Display Rule. Recent changes in the U.S. financial markets have reduced the information value of the NBBO. Investors will benefit from a change in the Display Rule, but a modified Display Rule should provide investors with more information about market conditions, not less.

Background

The 1970's marked a major turning point for securities markets in the United States. Prior to the 1970's, market centers were free to disseminate or withhold their market information as they saw fit. Each market center acted individually to determine who would have access to their market information, who would be denied, and the fees and terms under which access would be granted. In the early 1970's, the Securities and Exchange Commission recognized the public need for greater access to accurate and reliable market information. In response to this need, the Commission developed the concept of a central market system.

The Commission's vision of a central market system was articulated in a series of reports from the Commission to Congress in the early 1970's. In these reports, the Commission called for "the creation of a strong central market system for securities of national importance, in which all buying and selling interest in these securities could participate and be represented under a competitive regime."[3] Essential to this vision were the principles of transparency, fair competition, and best execution.

The Commission's vision of a central market system became a reality through the passage of the 1975 Amendments to the Securities Exchange Act of 1934. A primary goal of this legislation was "the centralization of all buying and selling interest so that each investor will have the opportunity for the best possible execution of his order, regardless of where in the system it originates."[4] Congress understood that the only way to achieve this goal was to ensure that all investors and their broker-dealers had access to consolidated market information from all

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[3] Letter of Transmittal accompanying the SEC Institutional Investor Study Report, H.R. Doc. No 92-64, 92d Cong., 1st Sess. (1971)

[4] S. Rep. No. 94-75, 94th Cong., 1st Sess. 7 (1975).

competing market centers. The current regulatory structure and arrangements for disseminating market information have met this goal for more than 25 years.

As our financial markets undergo unprecedented technological and competitive changes, it is natural to consider whether changes to the system of disseminating market information are warranted. Indeed, most participants in this process agree that improvements can be made. The governance structure of the SRO-sponsored plans to disseminate market information can be broadened to include a broader spectrum of the investment community. The fee structure can be simplified and the administrative burden of the fee structure can be reduced. The basic information product can be improved and competition among potential information processors can be encouraged.

As the Committee contemplates change, however, it is important to remember the fundamental principles that have served our markets so well for so long. The success of the United States securities markets has been unparalleled. And it would be a mistake to consider this success a fluke, or the result of random chance. Instead, it is important to recognize that much of the success of the U.S. capital market can be attributed to a few basic principles that guided the construction of our national market system. Among these principles, three are fundamental to the structure of U.S. securities markets: ***transparency, fair competition between market centers, and brokers' duty of best execution***. As Congress and the Commission have recognized, the critical component for implementing these principles is to ensure that market participants have access to consolidated, real-time market information.

Transparency. A transparent market is a market in which investors and their brokers have information about the current buying and selling interest in a security as well as information about the price and size of recent transactions. The Commission has long understood the importance of transparency for the basic price-setting function of a financial market. In its 1971 Statement on the Future Structure of the Securities Markets, the Commission recognized that only through transparency can we be assured "that buyers and sellers of securities, wherever located, can make informed investment decisions and not pay more than the lowest price at which someone is willing to sell nor sell for less than the highest price a buyer is prepared to offer."[5] Two years later, in its Statement on the Structure of a Central Market System, the Commission stated that securities can be valued accurately only when all indications of investor buying and selling interest are exposed to the greatest extent practicable, so as to increase the opportunity for demand to find supply.[6]

The benefits of transparency were illustrated in dramatic fashion when the Commission instituted new order-handling rules in January 1997.[7] The new order-handling rules applied to all U.S. equity markets. The greatest impact of the rules, however, was felt in the Nasdaq Stock Market. The most important of the new rules were known as the "Limit Order Display Rule" and the "Quote Rule."[8] The Limit Order Display Rule requires dealers to execute or display their customers' limit orders, or send them to another dealer or trading system that will execute or display them, whenever the customer's limit order improves the dealer's quote. This rule improved transparency by ensuring that the best-priced limit orders are displayed to all market participants.

The Quote Rule requires dealers to publicly display their most competitive quotes. Previously, the use of alternative trading systems, such as ECNs, permitted dealers to quote one set of prices for retail customers on Nasdaq, while offering more favorable prices to institutions and other dealers on an ECN. The Quote Rule requires dealers who place quotes in alternative trading systems to also make these quotes available to the public. The Quote Rule increased transparency by consolidating market information across the traditional and alternative trading systems.

These two changes in the consolidation and dissemination of market information resulted in an immediate reduction in investor trading costs of approximately 30%.[9] The greater transparency also helped restore investors' confidence in the Nasdaq market and likely contributed to the rapid growth in total trading volume and individual investor participation in this market. For example, between 1995 and 1998 there was a 25 percent increase in the

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[5] SEC, Statement of the Securities and Exchange Commission on the Future Structure of the Securities Markets (February 2, 1972) 37 FR 5286.
[6] SEC, Policy Statement of the Securities and Exchange Commission on the Structure of a Central Market System (March 29, 1973), p. 7.
[7] See Barclay, Michael J., William G. Christie, Jeffrey H. Harris, Eugene Kandel, and Paul Schultz, "The Effects of Market Reform on the Trading Costs of Nasdaq Stocks," Journal of Finance 54 (1999), pp. 1-34.
[8] Other changes instituted at this time included a reduction in the minimum quote size from 1,000 shares to 100 shares for certain Nasdaq issues and a relaxation of the Excess Spread Rule.

percentage of U.S. families with direct stock ownership (from 15.3 percent to 19.2 percent) and a 38 percent increase in the percentage of families with direct ownership of mutual funds (from 12 percent to 16.5 percent).[10] In the four years following the implementation of the new order handling rules, Nasdaq share volume has nearly tripled (from 138 billion shares in 1996 to 428 billion shares in 2000.

Greater transparency contributes to more efficient price discovery, lower price volatility, lower trading costs, and greater public confidence in the financial markets. Any plan for disseminating market information that stops short of disseminating fully consolidated information would reduce the transparency of the market and, consequently, reduce the benefits from transparency that we currently enjoy. If an investor observes bid and ask quotations that are not fully consolidated, that investor is deprived of the opportunity to know the best price available for the security in the marketplace as a whole. The widespread use of unconsolidated market data would impair investors' ability to make informed investment decisions or monitor the quality of the executions achieved by their brokers.

Fair competition between market centers. One of the principal objectives of the national market system is assuring fair competition among market centers.[11] Congress and the Commission have sought to establish a market structure that gives the forces of competition room to flourish and develop. In the view of the Commission, "Competition among market centers, in which each market center strives to attract order flow from intermediaries based on the overall quality of its market, has proven to be a primary force in improving the operation of the markets. It has encouraged innovation in trading systems, fostering the use of new technology and creative trading rules to offer an array of execution choices. Vigorous market center competition has driven markets to offer faster executions, charge lower fees, and provide greater liquidity at the best quoted price."[12]

The U.S. securities markets have benefited greatly from the competition between market centers. Many improvements to our financial markets have been generated by innovation and

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[9] Ibid., p. 32.
[10] Federal Reserve Board Triennial Survey of Consumer Finances. The data for mutual funds excludes money market funds and mutual funds held in retirement accounts.
[11] Section 11A(a)(1)(C)(ii) of the Exchange Act, 15 U.S.C. 78k-1(a)(1)(C)(ii).
[12] SEC, "Proposed Rule: Disclosure of Order Routing and Execution Practices," Release No. 34-43084; File No. S7-16-00.

competition away from the dominant market for a traded security. In addition to competing directly through the quotes, the smaller and newer market centers have competed effectively by offering executions that are faster, cheaper, and more reliable. For example, the regional exchanges were the first to develop automatic order execution systems and to extend automatic order routing. Given recent changes in technology, the potential benefits from competition between market centers are greater today than ever before.

Fair and vigorous competition between market centers, however, requires that investors have access to consolidated market information. If broker-dealers are unable to see quotes and last sales from smaller exchanges, they are likely to route orders to larger markets by default. This would have a severe negative impact on the ability of smaller markets to compete.

Most participants in this process would agree that more competition is preferred to less. Thus, it is not surprising that many of the comments and proposals received by the Commission called for greater competition in the dissemination of market information. The dissemination of market information can be more competitive, and several proposals for fostering greater competition in this arena are provided below. It is important that in its effort to increase competition for the dissemination of market information, however, the Commission does not simply substitute an inferior mode of competition for a superior one. Investors will benefit most if market centers continue to compete aggressively for their orders. Thus, it would be a mistake for the Commission to change the rules in such a way that market centers were encouraged to compete in the arena of market information rather than competing for orders directly.

Best execution. Most investors do not trade securities directly, but do so indirectly through their brokers. The brokers in these transactions have a fiduciary obligation to get the best possible execution for their customers. Best execution rules are important because they ensure that all investors actually receive the benefits from a competitive marketplace. Without access to consolidated market information, however, brokers could not meet the current standard for best execution, and investors would suffer as a result. Sophisticated institutional investors may be able to protect themselves in a world without the current best execution standards. With a full-time staff and investments in data and infrastructure, they can monitor their brokers' executions and compensate or fire them accordingly. Most retail investors, however, cannot protect themselves in this way because they lack the expertise, the resources, or both. If broker-dealers exercising their fiduciary responsibilities on behalf of their customers cannot see and judge prices and executions offered by smaller or newer markets, they will not be confident in their ability to send orders to these markets – and these markets would be doomed in the competition for order flow.

The brokers' duty of best execution has been the focus of recent Commission rule making. The Commission recognized that with many different market centers trading the same security, the decision of where to route orders to obtain best execution for investors is critically important. To help brokers fulfill their obligation, the Commission proposed Rule 11Ac1-5 (Disclosure of Order Execution Information) that requires market centers to prepare and make available to the public monthly reports that set forth uniform statistical measures of execution quality. Any proposals that result in the dissemination of unconsolidated or lower-quality information to investors is in direct conflict with these Commission initiatives.

The Commission should consider changes to the Display Rule. Any changes, however, should provide for the display of more information, not less

The Display Rule requires that when disseminating quotations in individual stocks to customers, vendors and brokers must include either the best bid and best offer from all reporting markets trading a particular security or a montage showing quotations from all reporting markets. In addition, vendors and brokers must provide the last sale prices for the security from all reporting markets.[13] For the reasons discussed above under the headings of transparency, fair competition between market centers, and best execution, the Committee should not consider any changes in the dissemination of market information that would provide investors with less information than they are guaranteed under the current Display Rule. Competition in the dissemination of market information will hurt rather than benefit investors if the result of the competition does not provide investors with fully consolidated real-time market information.[14]

The Commission made a strong case for the importance of the Display Rule in a letter, submitted amicus curiae, in a recent arbitration.[15] In its letter, the Commission concluded that

[13] Exchange Act Rule 11Ac1-2, 17 CFR 240.11Ac1-2.
[14] See note 9 and accompanying text.
[15] American Stock Exchange LLC, et al. v. Reuters Limited, No. 13 113 00471 00 (American Arbitration Association).

when a vendor disseminates unconsolidated market information it "thwarts the goals of the Exchange Act – particularly the goals of fostering transparency and encouraging competition. This type of limited dissemination makes it possible, even probable, that smaller or newer exchanges, even if they have better prices, will be unsuccessful in widely disseminating their market information, thereby depriving market participants of that information and impairing exchange competition."[16]

Recent changes in the market, such as the reduction in the minimum tick size (decimalization), have reduced the depth of the market at the best bid and offer. These changes have reduced the information value of the NBBO, particularly for investors who make large trades. For example, a recent study examined the impact on institutional trading costs when the New York Stock Exchange lowered its minimum price increment on most stocks from eighths to sixteenths in 1997.[17] Although average quoted spreads declined with the smaller tick size, the realized execution costs for these institutions increased. The authors of this study concluded that the best quoted bid and ask prices are not a sufficient statistic for market quality, particularly for large orders. Thus, it is appropriate at this time for the Commission, and this Committee, to consider changes to the Display Rule. Any changes to the Display Rule, however, must give investors access to more market information, not less.

The current regulatory structure for disseminating market information is not broken and should not be abandoned.

The current regulatory structure requires SROs to act jointly, pursuant to various national market system plans (the "Plans"), to disseminate consolidated market information. The Plan Governance Committees[18] govern all aspects of the arrangements for disseminating market information. They require each individual SRO to funnel market information to a central processor, which then consolidates the information into a single stream for dissemination to the

[16] SEC Letter to Tamara B. Young in re: American Stock Exchange LLC, et al. v. Reuters Limited, No. 13 113 00471 00 (American Arbitration Association), February 5, 2001.
[17] Charles M. Jones and Marc L. Lipson, "Sixteenths: direct evidence on institutional execution costs," *Journal of Financial Economics* 59 (2001), pp. 253-278.
[18] The Plan Governance Committees are the CTA and the OTC/UTP Participants.

public. The Plan Governance Committees also govern the fees that can be charged and the distribution of revenues derived from those fees.[19]

All of the existing national market plans require the SROs to transmit market information to an *exclusive* consolidator, or registered securities information processor (SIP). The exclusive consolidator then transmits the consolidated market information, for a fee, directly to subscribers, or to vendors, who augment the original feed with additional data and/or processing software and resell it.

The use of an exclusive consolidator to collect and disseminate the consolidated market information required by the Display Rule is an efficient mechanism for accomplishing this task that has worked reliably for more than 25 years under extremely diverse and rapidly changing market conditions. For example, when this system was initiated in 1975, total annual trading volume was approximately 4.7 billion shares on the New York Stock Exchange and 1.4 billion shares on Nasdaq.[20] By the year 2000, volume on the NYSE increased 55-fold to 262 billion shares while volume on Nasdaq increased more than 300-fold to 428 billion shares. The single-day volume records of 2.1 billion shares for the NYSE on January 4, 2001 and 3.2 billion shares for Nasdaq on January 3, 2001 were unimaginable only a few years ago. It was not until 1979 that Nasdaq traded in a full year the number of shares that they traded in a single day in January of 2001. While the quantity of trade and quote information was exploding, the demand for access to this information was also growing exponentially, particularly among retail investors. Between 1994 and 1998, revenues from market-information fees applicable to retail investors grew 10-fold, from \$3.7 million to \$38.9 million.[21]

During this period of unprecedented growth, the Plan Governance Committees kept pace with technological change and expanded capacity as necessary to process and disseminate the ever-growing volume of information. At the same time, market-information fees declined significantly. For example, most of the fees applicable to retail investors were reduced recently by 50 to 80 percent.[22] Today, any vendor, broker-dealer, institution, or retail investor who wants

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[19] SEC Concept Release: Regulation of Market Information Fees and Revenues, Release No. 34-4228, File No. S7-28-99, p. 6.
[20] Volume statistics for the NYSE and Nasdaq are available from the Market Data pages of the exchange web sites, http://www.nyse.com and http://www.nasdaq.com.
[21] SEC Concept Release: Regulation of Market Information Fees and Revenues, Release No. 34-4228, File No. S7-28-99, p. 5.
[22] Ibid.

access to market information can and does obtain it at very low cost. Consider, for example, a retail investor who wants to trade 500 shares of common stock. This investor might pay as much as $8 to $75 in brokerage commissions, and as much as an additional $30 or more in spread-related trading costs. However, if the same investor makes as many as 100 data queries associated with this trade, at the current rate of a quarter of a cent per query, the market-information cost would be only 25 cents.

The willingness and ability of the Plan Governance Committees to expand capacity, cut costs and fees, and adapt to the changing marketplace suggests that the current governance structure of the Plans works well. All important operating decisions of the Plans are made by the Governance Committees, which are composed of one representative from each SRO participating in the plan. The SROs' member firms are the primary users of the market information and pay a large fraction of the market-information fees. Pressure from the member firms through their representation on the SRO boards, and oversight by the Commission, have proven to be effective in moving the Plan Governance Committees to provide a reliable product with low and declining prices.

Critics of the existing system argue that by virtue of its status of as an exclusive processor, the consolidator is not constrained by the forces of competition and thus has no incentive to innovate, improve the product, cut costs, or lower fees. It is true that fees charged by the exclusive consolidator are not constrained by competition and consequently must be subject to oversight by the Commission. However, the evidence from the last quarter century demonstrates that the exclusive consolidator has not abused its market power by imposing excessive charges for market information. Further, alternatives to the exclusive consolidator appear to make the situation worse, not better.

The logical alternative to an exclusive consolidator is to allow multiple competing consolidators to purchase market information directly from the various market centers, or from each other, and then resell this information to subscribers at market-determined prices. For reasons discussed above, it is essential that investors continue to have access to fully consolidated market information. If the Commission requires vendors and brokers to provide consolidated market information to their customers, then a multiple vendor structure places each market center in a monopoly position with respect to its own market information. None of the competing consolidators can provide a consolidated feed without obtaining market information from each and every market center. Thus every market center would have an incentive to hold their information back and extract the monopoly price. This situation is no more competitive, and certainly more complex, than using an exclusive consolidator. Rather than the current situation, in which the Commission must oversee the fees charged by an exclusive consolidator, the multiple-consolidator model thrusts the Commission into a position of regulating the market-information fees charged by each and every reporting market center. No one is made better off by substituting many smaller monopolies for one larger monopoly in this market.

The Commission's former Chairman, Arthur Levitt, discussed the problem of allowing market centers to sell their information in a recent address at Stanford University. According to Chairman Levitt, "allowing unfettered market forces to dictate the cost of pricing data is in direct tension with the mandate for market transparency. Put another way, if market forces allow a dominant market to name the price for its data, this also means the market can withhold the data if it does not get its price. Suffice to say, the implications are not only in conflict with Congress' mandate, but wholly unacceptable for America's investors. Too many investors would be forced to price orders in the dark. The current pricing standard – the NBBO, or national best bid and offer – could be supplanted by scattered patches of varying prices, visible to only a few."[23]

A system with multiple consolidators is also inherently inefficient because multiple consolidators will lead inexorably to a duplication of effort. Each competing consolidator must collect the same market information from every market center and consolidate it in a single data feed. This duplication of effort will result in higher total costs for collecting and consolidating the market information, and the higher costs will have to be passed through to market participants in the form of higher fees.

Greater competition is possible within the current regulatory structure. The goal of promoting increased competition among providers of market information is useful and appropriate. Although competition among multiple consolidators is inefficient and leads to undesirable side effects, greater competition within the exclusive consolidator structure is certainly possible. Two areas in particular seem easily amenable to greater competition. First, although the structure of an exclusive consolidator would be maintained, the exclusive

[23] "The National Market System: A Vision That Endures" – Remarks of Chairman Arthur Levitt, at Stanford

consolidator contract could be subject to periodic public competitive bid. Any potential consolidator meeting Commission standards, including existing consolidators, SROs, and vendors, would be invited to submit bids. This regular competitive pressure would help ensure that market information is being provided at the lowest possible cost to subscribers, subject to appropriate quality standards.

The Plan Governance Committees currently monitor and evaluate the performance of their SIPs through biennial internal reviews. Putting the SIP contract up for periodic public competitive bid is a mechanism for making this process more open and public. In addition to increasing the competitive pressure on SIPs to cut costs and improve the reliability of the product, public competitive bidding for the exclusive SIP contract could allow an SIP to bid for multiple contracts. The administrative burden placed on brokers and vendors from contracting with multiple market-information Plans would be reduced if a single SIP won the contract for multiple Plans.

Second, there already is significant competition among downstream vendors. These vendors purchase the basic consolidated data feed from the exclusive consolidator and augment the basic produce with additional data and/or software for improved processing display. Vendors already compete vigorously with each other and have all of the right incentives to innovate, improve the basic product, and reduce costs.

Revenues from market-information fees are an appropriate source of SRO funding. SROs play a unique role in U.S. securities markets. SROs have the front-line responsibility for operating and regulating the U.S. listing markets. Through their regulatory function, SROs protect the integrity of our markets, promote investor confidence in the fairness and transparency of the markets, and ensure that our securities markets are operated and regulated in accordance with the high standards mandated by Congress. SROs also contribute to the stability of our financial system through the affirmative obligation of their members to make a two-sided market in the securities that they trade, an obligation unique to SROs. They promote competition within their organizations and compete aggressively with each other.

The wide range of regulatory and operational responsibilities that are required from an SRO spare the federal government much of the burden of regulating U.S. securities markets. The

University, Stanford, Calif., January 8, 2001.

regulatory and operational activities of the SROs must be funded, however. Historically, the revenues derived from market-information fees have been an important source of SRO funding that has allowed the SROs to meet their unique responsibilities. In its concept release, the Commission attempts to parse out various categories of SRO costs – some of which would be funded by market-information revenues and some of which would not.[24] The process of segmenting the costs incurred to generate and disseminate market information, and particularly the process of artificially allocating common costs, is inexact, contentious, subject to manipulation, and should not be undertaken by the Commission. As discussed above, rate-making regulation is not necessary to ensure that the exclusive consolidator does not abuse its market power by setting excessive or discriminatory market-information fees. The Commission should use its oversight to ensure that market-information fees are fair and reasonable. However, the Commission should not interfere with or micromanage the day to day operations of the SRO.

The Concept Release notes that market-information revenues allow SROs to recover some of the costs of operating their markets, and that this source of revenue is not available to other types of entities that operate markets such as alternative trading systems and ECNs.[25] This distinction between SROs and ATSs is important and appropriate. SROs are charged with a wide range of tasks and responsibilities that do not apply to an ATS, and it is wholly appropriate to fund these unique SRO activities. The Commission's ATS Release made it plain that an ATS has the choice of registering as a securities exchange and accepting all of the many responsibilities imposed by the Exchange Act on SROs, or registering as a broker dealer. If an ATS believes that the benefits of registering as an SRO, including receiving a share of the market-information revenue, exceed the costs, then the ATS has the option to register as an exchange.[26] Finally, the ATSs are members of an SRO, and several SROs have rebate plans in place to distribute market-information fees back to their members. If an ATS believes that they should participate in the market-information fees, this is an issue that they can pursue within their SRO.

As the Committee considers changes to the structure of market-information fees and revenues, it is important to recognize the important and unique role played by SROs, and ensure

[24] SEC Concept Release: Regulation of Market Information Fees and Revenues, Release No. 34-4228, File No. S7-28-99, pp. 26-28.
[25] Ibid., p. 28.

that they have the funding they need to meet their unique obligations. Revenues derived from market-information fees are an appropriate source of SRO funding that should be preserved. The process of ensuring a fair and equitable rate setting is addressed below.

The governance structure of the Plans should be modified to include a broader spectrum of the investment community

The investment landscape has changed dramatically in recent years. Technological change and innovation has led to significant changes in the operation of our listing markets and to a rapid growth in the number of market centers and alternate trading systems. These changes have fundamentally altered the demand for market information and the constituents for whom market information plays an important role. In light of these changes, the governance structure of the national market system plans should be modified to include a broader spectrum of the investment community.

The composition of the SEC Advisory Committee on market information reflects the diverse range of stakeholders in this process. Both the buy side and sell side of the market, market data vendors, alternative trading systems and ECNs, and the listing markets and exchanges all have vested interests in the dissemination of market information. Most of the criticisms of the existing system could be addressed fairly and efficiently through the Plan governance process if the governance structure were more inclusive.

Broader Governance Committee representation will help stimulate innovation and product improvement. Critics of the existing system contend that the exclusive processors do not have the incentive to make required investments or improve the basic information product. As noted above, competition from downstream vendors can help to mitigate this problem. If there is a demand for additional market information, or a demand for market information in a different format than is currently supplied, market data vendors are free to purchase the basic data feed from the exclusive consolidator and augment and display the information in any format the market demands.

Competition from downstream vendors is only a partial solution to this problem, however. The Plan Governance Committees are in a unique position to provide investors with

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[26] Ibid.

fully consolidated market information. If changes in the markets create widespread demand for different market information, the Plan Governance Committees are in the best position to provide it. For example, the reduction of the minimum tick size on stock markets was accompanied by a greater number of quote updates and reduced depth at the NBBO. For many investors who wish to trade even moderate-size positions, the best bid and offer are no longer a sufficient indication of the current buying and selling interest in the security. If these changes imply that additional market information is required to augment the NBBO, the Plan Governance Committees are in a unique position to provide this information on a consolidated basis.

Broader Governance Committee representation can help ensure that investors continue to have access to the information they need. As the markets change and the demand for market information evolves, direct representation of the interested parties on the Plan Governance Committees will ensure that these voices are heard and will move the Plans to provide the market information that investors demand.

Broader Governance Committee representation will help ensure that market-information fees are fair and reasonable, and can streamline the administration of the fee structures. Critics of the existing system contend that market-information fees are too high, that the fees are inequitable and unfairly disadvantage one group of users in relation to another, and that the administrative burden required to comply with the current pricing model is excessive. Although there are good reasons to be skeptical of the merits of these claims, broader representation on the Plan Governance Committees is an appropriate way to address these concerns. By giving the interested parties a direct voice in the administration on the plans, the Commission can place the various constituents in a much better position to protect their interests.

By resolving disputes over the level, distribution, and administration of market-information fees through broader representation on the Plan Governance Committees, the Commission also is spared from the problematic task of overseeing a strict cost-of-service (or rate-making) approach to setting market-information fees. Several commentators have provided lengthy discourses on the undesirable characteristics of cost-based regulation. Strict cost-based regulation would serve no one in this process, and should not be considered by the Committee when a simple and equitable solution is readily available.

Conclusions

The existing national market system plans for consolidating and disseminating market information have contributed to the unparalleled success of U.S. securities markets over the past 25 years. Although some modifications to the Plans may be necessary and appropriate at this time, the basic structure of the Plans has proven to be efficient and adaptable to changing market conditions, and will serve our financial markets for many years to come. This Committee and the Commission must resist proposals for radical change because the unintended consequences of radical change have the potential to harm the interests of investors and could seriously impair the functioning of our financial markets.