

January 17, 2007

Nancy M. Morris
Secretary
U.S. Securities and Exchange Commission
100 F. St. N.E.
Washington, D.C. 20549-0609

Re: In the Matter of NetCoalition, File No. SR-NYSEArca-2006-21

Dear Chairman Cox and Commissioners:

The Securities Industry and Financial Markets Association (“SIFMA”)¹ applauds the Securities and Exchange Commission (“Commission” or “SEC”) for its unanimous decision to grant NetCoalition’s petition for review of the Staff’s approval of NYSEArca’s “ArcaBook” market data fee and for the Commission’s willingness to address the pressing market data issues SIFMA has raised in this matter and others over the last few years.² The ArcaBook product consists of “depth-of-book” market data which, pursuant to SEC rules, broker-dealers submit to NYSEArca in its capacity as a registered exchange. Until now, NYSEArca in turn redistributed this market data back to broker-dealers and investors free of charge as a way to publicize the liquidity - quotes and orders - available in its marketplace to help generate trading activity.

By imposing a fee, NYSEArca potentially will be eliminating access to this data for millions of investors. Although SIFMA does not oppose the imposition of some fee, that fee must be reasonably related to market data costs and it must be reviewed in light of the investor protection and transparency goals of the Securities Exchange Act of 1934 (“Exchange Act”). NYSEArca, like other exchanges which operate today as exclusive processors of data that broker-dealers submit to them, faces no competition when it comes to setting market data fees. This requires heightened Commission review.

¹ The Securities Industry and Financial Markets Association brings together the shared interests of more than 650 securities firms, banks and asset managers. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests locally and globally. It has offices in New York, Washington D.C., and London and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong.

² SIFMA's comment letters to the Commission on market data issues are listed *infra* at n.19.

NYSEArca's position as an exchange mandates that its market data fees must be "fair and reasonable," "not unreasonably discriminatory," and an "equitable allocation" of costs. By failing to provide any cost-based or other evidence to substantiate its proposed fee, NYSEArca failed to demonstrate how it met those standards and there was insufficient basis for the staff's order of approval.

Accordingly, we submit this letter to urge the Commission to vacate the Staff's order in this matter and impose a moratorium on approval of market data rule filings until the Commission is able to address the fundamental legal and policy issues raised by NetCoalition's petition for review:

- The conflicts of interest of for-profit exchanges and the exchanges' ability to profit by using their regulatory status to sell market data for commercial gain in an area where they do not face competition - market data that is necessary for price discovery;
- The lack of a meaningful standard to assess the fairness and reasonableness of fees for the new single-exchange market data products (as well as for consolidated market data products), which investors must pay to obtain a rapid, accurate and full picture of the quotations so that investors can place informed orders and understand what is happening in the market; and
- The impacts on competition, efficiency, and broker-dealer obligations arising from the speed and content disparity between the slower consolidated quotation required by Commission rules (a single data point of the best price in the market for as few as one hundred shares), and the new single-exchange quotation products like ArcaBook which provide faster and deeper pricing data.³

After discussing the broad themes in the Executive Summary and highlighting the key deficiencies in the NYSEArca filing, we then describe in more detail the regulatory and market structure developments that SIFMA believes require prompt Commission intervention to ensure "fair and reasonable" and "not unreasonably discriminatory" access to market data fees for *all* investors. Finally, we offer suggested long-term regulatory approaches that may obviate the need for the Commission to scrutinize fees akin to a rate-making proceeding. SIFMA and its members look forward to working with the Commission, its Staff, and the exchanges to develop a new and necessary

³ News reports indicate that NYSEArca may launch a pilot program to make real-time last sale data (but not any quote data, much less the free real-time "depth of book" data available from Arca prior to the NYSEArca merger) available to financial portal websites for a single monthly enterprise fee. Aaron Lucchetti, *NYSE Test May Give Investors Real-Time Quotes Via the Web*, Wall St. J. (Jan. 12, 2007) at C3. Such a development would not make the issues in this petition moot: last sale data, while important, is not the equivalent of quote data for investors trying to understand at what prices their orders might be executed. If NYSEArca does launch such a pilot, it is important that it be available on a non-discriminatory basis to everyone, not just financial portal websites.

framework for market data for the 21st century to promote competition and ensure the protection of all investors.

I. Executive Summary

Gerald D. Putnam, Jr., now the President and Co-Chief Operating Officer of NYSE Group and former Chairman and Chief Executive Officer of Archipelago Holdings, LLC, succinctly pointed out the problems with the exchanges' market data pricing in testimony to a House of Representatives subcommittee five years before Archipelago's merger with the NYSE:

Market forces neither impact the plans nor provide incentives to offer competitive rates. Instead, vendors and broker/dealers are presented with the classic Hobson's choice: doing business based on monopolistic terms or not doing business at all. In this sub-competitive environment, valuable market data is sold to vendors and broker/dealers and then distributed to millions of retail and institutional investors, forcing investors to pick up the tab for non-competitive pricing. Without competitive forces to discipline markets, economic distortions result. *No one really knows if market data fees are too high or too low.*⁴

A few years later in 2003, market data revenue for the self-regulatory organizations ("SROs") totaled over \$386 million for consolidated market data alone (not including "depth-of-book" products such as the one at issue here), while the network expenses totaled just over \$38 million - a markup of over 1000%.⁵ Although some exchanges have argued that the data used to calculate this markup did not include the exchanges' costs in collecting the data, those exchanges were not willing to disclose any estimate of those costs.

And what was true then is even truer today as the largest exchanges have become for-profit enterprises and are growing as a result of mergers with their competitors. The NYSE Group, for example, reported that its market data revenues for the third quarter of 2006 totaled \$57.5 million: up 33.7% from the same three month period in 2005. It attributed its revenue growth in market data "*primarily to the contribution of NYSEArca's operations, following the completion of the merger between the NYSE and Archipelago on March 7, 2006.*"⁶ Its pre-tax margin grew from 7.5% to 23.6%

⁴ Written Statement of Gerald D. Putnam, Jr., Chairman and Chief Executive Officer Archipelago Holdings, L.L.C Concerning Public Access to Stock Market Data – Improving Transparency and Competition (Committee on Financial Services: Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises, United States House of Representatives, March 14, 2001) (emphasis added).

⁵ Exchange Act Rel. No. 49,325 (Feb. 26, 2004), 69 Fed. Reg. 11126, 11179 (Mar. 6, 2004).

⁶ NYSE Group, Inc. Form 10-Q for the quarterly period ending Sept. 30, 2006 (emphasis added).

during the same period.⁷ As described further below, Nasdaq has reported similar growth, both in its market data revenues and in its overall profits. NYSEArca and Nasdaq have not presented any data to the Commission or to the public to show that their rapidly growing market data revenues are “fair and reasonable.” Unless checked by effective regulatory oversight, these exchanges have both the incentives and the power to charge whatever they can for the market data over which they have exclusive control. Unfortunately, as illustrated in Appendix A, the exchanges propose to charge fees for a series of market data products that, when multiplied by the number of potential subscribers, are resulting in increased costs of doing business totaling tens of millions of dollars per year for some individual firms and hundreds of millions of dollars per year across the financial markets.

Measured by liquidity, depth, speed and impartiality, the U.S. securities markets are among the very best in the world. A lynchpin of this success has been the market data system, which delivers real-time quotes and the latest sale prices across all markets for securities traded on our exchanges. As the Commission has long recognized, accurate, complete and timely information about transactions in, and bids and offers for, securities is critical to the effective functioning of the securities markets. Congress specifically recognized the importance of market data when it made “the availability to brokers, dealers and investors of information with respect to quotations for and transactions in securities” one of the key policy goals for a national market system.⁸ The Commission should reevaluate how to uphold this congressional mandate in light of recent and fundamental changes in our market and regulatory structure.

The Exchanges’ Profit Motive Conflicts with the Congressional Mandate to Promote Transparency. As illustrated by NYSEArca’s decision to begin charging for market data that Arca had made available without charge prior to its merger with the NYSE, recent regulatory and industry developments have endangered the broad availability of the fastest, most informative securities market data for all investors. The exchanges which control the distribution of market data have gone from being member-owned, not-for-profit companies to shareholder-owned, for-profit companies. As for-profit enterprises, the exchanges have an inherent conflict of interest due to their incentive to maximize the profits from the sale of market data that they uniquely control under the protection of government regulation.

The largest exchanges, such as the NYSE, have merged with competitive alternative trading systems (“ATSS”) such as Arca. The resulting mergers have reduced competition for liquidity and thereby increased the “network effect” that the larger concentrated pools of liquidity produce, allowing the for-

⁷ NYSE Group, Inc. Form 8-K filed November 16, 2006, Exhibit 99.1 (presentation at the Merrill Lynch Banking & Financial Services).

⁸ See Exchange Act Section 11A(a)(1)(C)(iii), adopted as part of the 1975 Act Amendments to the Exchange Act. The legal framework for market data regulation is discussed in Appendix B below.

profit exchanges to charge for market data that Arca and other ATs offered for free to attract liquidity when they were independent. The major exchanges have created new unconsolidated, single-exchange market data products that have significant advantages over the consolidated, top-of-book market data products generally available to investors. The exchanges with the largest liquidity pools have the power to maximize their profits in the sale of their market data products. Instead of passing through the benefits of increased economies of scale and scope resulting from their mergers, the exchanges have used their new market power to raise market data prices. As NetCoalition's petition correctly points out, it is the investing public that will suffer the consequences.

Unfortunately, the NYSEArca fee proposal is only an isolated example in a "land rush" of proposals to charge investors fees for important market data. Although SIFMA has addressed these issues in the ArcaBook proposal and the other fee proposals individually, we believe the proposals not only have common origins but also raise common issues that can only be addressed collectively. We urge the Commission Staff to conduct a methodical economic analysis of these fundamental changes in market structure as part of its fee review and approval process for market data rule filings, an analysis it does not appear to have conducted on such filings to date.⁹ Particularly in light of the NYSEArca and Nasdaq/INET/BRUT consolidations, the Commission should investigate whether the fees the exchanges are proposing to charge are the result of competitive market forces, or are the result of the exchanges' exercise of market power to charge more than a fair and reasonable price.

"Depth-of-Book" Market Data Is More Essential After Decimalization and Regulation NMS.

Meanwhile, Regulation NMS has accelerated the transition towards automated trading, and, together with decimalization, has made information about "depth-of-book" quotation interest relevant to a broad range of investors. While the NYSE and NASD are in the process of consolidating many of their regulatory functions into a separate, single SRO, the current regulatory structure continues to give the for-profit exchanges a unique position with regard to the market data that they exclusively control. This control is granted under SEC rules which require broker-dealers to report their – and their customers' – trades, bids, and offers to the exchange to maintain a fair and orderly market, as part of the exchange's self-regulatory or quasi-governmental (not commercial) role.

As a result of the increasing expectations of the Commission and the SROs for best execution monitoring, many broker-dealers and asset managers have concluded it is prudent to purchase,

⁹ Chairman Cox recently directed the Commission's General Counsel to conduct a review of the Commission's process for complying with the National Securities Markets Improvement Act of 1996 and other laws that require an economic analysis of rule proposals. The purpose of the review was to ensure the SEC takes full advantage of the significant expertise of its professional staff—both in the operating divisions and in the Office of Economic Analysis—when preparing the analysis of economic impact that must accompany proposed regulations. See Commission Press Release 2006-95 (June 13, 2006). Exactly such an economic analysis would be appropriate here to assure that market data rule filings meet the statutory standard of not imposing an undue burden on competition.

maintain and analyze faster single-exchange “depth-of-book” market data products. The NYSE itself linked its single-market “depth-of-book” market data and best execution when it stated that “NYSE Arca’s market data products are designed to improve trade execution.”¹⁰ Further, denying most investors the ability to see the prices at which their orders are likely to be executed clearly defeats the intent of Regulation NMS’s Order Protection Rule.¹¹ All investors – whether professional or non-professional, whether accessing information for institutional trading systems, through a broker-dealer, through an Internet portal, or directly from an exchange – should have equal access to the same quality information, at a reasonable price, and at the same time. The current market data system, in which the exchanges’ fee proposals have been routinely approved without any analysis of the costs of preparing that data or of the changes in the markets, imposes significant costs on the markets and is inconsistent both with best execution principles and with Regulation NMS.

The Commission Should Address Key Questions Regarding and Adopt a New Framework for Market Data. The significant changes in market and regulatory structure indicate that the Commission should reconsider its oversight of market data; thus, we commend the Commission for granting the NetCoalition petition so it may engage in this rethinking process. In doing so, SIFMA respectfully urges that the Commission address a set of policy issues that, among others, will determine how it evaluates market data rule filings:

1. How can the Commission best structure the regulation of national markets and best evaluate individual market data rule proposals to ensure that the rule proposals that it approves are fair and reasonable?
2. Each exchange has government-sponsored control over the distribution of market data generated by participants in its market. Is this exclusive control appropriate in a world of for-profit exchanges and, if so, how does it further investor protection and investor interests? How does the pending consolidation of SRO regulatory functions at a single self-regulator affect this decision?

¹⁰ NYSE Group, Inc. Form S-1 at 122 (filed March 13, 2006) (emphasis added).

¹¹ The Commission stated its goals for Regulation NMS in the adopting release:

First, strengthened assurance that orders will be filled at the best prices will give investors, particularly retail investors, greater confidence that they will be treated fairly when they participate in the equity markets. Second, protection of the best displayed and accessible prices will promote deep and stable markets that minimize investor transaction costs.

Exchange Act Release No. 51,808 (June 9, 2005) at 11. This focus on retail order execution cannot be reconciled with a market data system in which most investors do not even see quotes until well after other investors have had an opportunity to interact with them, and the size of the quote most investors see may be as small as 100 shares.

3. Are market data fees today diverted by the exchanges to fund for-profit competitive endeavors such as acquisitions or trading rebates, and not just self-regulation or the cost of collecting and distributing the data? If so, how should this be factored into a review of market data pricing?
4. Given the limited liquidity reflected in the consolidated quote and its comparatively slow speed, is “depth-of-book” data or other data distributed by individual exchanges essential in today’s decimalized environment to make pricing transparent and fair to investors?
5. What is the impact of the availability of “depth-of-book” data on best execution obligations, and how should that impact be factored into review of market data pricing?
6. What information about costs and revenues should the exchanges be required to disclose to meet the Exchange Act’s statutory standard of fair, reasonable, and equitable allocation of costs to assure investors that the market data process is open and transparent?
7. Given the effective regulatory obligation of broker-dealers and other market participants to buy market data and the control that the exclusive processors have in providing that market data, how can pricing based on a subjective notion of “value,” or based on what the market will bear, result in a fair and reasonable price?
8. Because each exchange sets the fees for the data over which it has exclusive control, how meaningful is it to use one exchange’s fees as a benchmark to measure the fairness and reasonableness of another exchange’s fees?
9. How can the Commission ensure that it receives full and accurate information concerning the fees proposed to be imposed and the contract terms under which exchanges will impose the fees for market data on broker-dealers and investors? Should these terms include imposition of duplicative charges for the same user and requirements to track downstream usage of the data?
10. Given the economic distortions inherent in the exchanges’ control over market data, is a structural solution necessary to introduce competition (as a substitute for rate reviews) into the market data system? For example, should market data exclusive processing functions be moved into a separate affiliate, and should the exchange’s exclusive processor be required to provide the raw data stream on equal terms to third parties who could also process that data?

This letter attempts to address these questions. We urge the Commission to vacate the approval order below and impose a moratorium on the approval of new market data rule filings until the Commission has addressed the important policy issues and developed a consistent approach and standards for evaluating fee proposals.¹²

A New Market Data Framework Should Promote Equal and Widespread Access To Information.

The price of market data has a direct impact on its availability and on who can access it. In order for an exchange to justify a market data rule proposal as “fair and reasonable,” “not unreasonably discriminatory” and representing “an equitable allocation of costs” as required by the Exchange Act, the Commission should require the exchanges to submit information regarding the exchange’s cost to collect, consolidate and distribute that market data.¹³ The Commission should make it clear that the exchanges may take into account only their legitimate costs in producing the market data that they control.¹⁴ However, exchanges may not use their control to charge unfair or unreasonable fees for the market data at a level that would enable them to cross-subsidize their competitive operations.¹⁵

The Commission should explore structural alternatives that would introduce competition in value-added market data products as a supplement to, or even substitute for, cost-based regulation. The exchanges compete today for listings, investment products, and services they provide to traders and other users of an exchange. The Commission should encourage a structure in which they can compete also in the area of market data products. Today, however, they use exclusive control over basic market data (facts about orders and quotes submitted by broker-dealers) to package simple consolidation as a “product” for which they charge a fee unconstrained by market forces. A structural alternative for a new market data framework could include requiring each exchange to place market data operations in a separate subsidiary, and requiring each exchange to sell raw market data on the

¹² This moratorium should include market data rule proposals filed for immediate effectiveness, and the Commission’s review should address whether some market data rule filings that already have been approved should be reconsidered under the new standards the Commission adopts.

¹³ The Commission has repeatedly stated that the “fair and reasonable,” “not unreasonably discriminatory” and “equitable allocation of costs” standards are the relevant tests for evaluating exchange market data rule filings. See e.g., Market Data Concept Release, Exchange Act Release No. 42,208 (Dec. 9, 1999) at n.47. NYSEArca’s response to the NetCoalition Notice of Intention to Petition does not contest that Exchange Act Sections 11A(c)(1)(C) and 11A(c)(1)(D) provide the relevant statutory standards for review of its market fee proposal: whether the market data rule at issue is “fair and reasonable” and “not unreasonably discriminatory.” (Nov. 8, 2006 at p.4).

¹⁴ In its initial Regulation NMS Proposing Release, the Commission noted that in 2003, market data revenue for the SROs totaled over \$386 million for consolidated market data alone (not including “depth-of-book” products such as the one at issue here), while the network expenses totaled just over \$38 million - a markup of over 1000%. Exchange Act Release No. 49,325 (Feb. 26, 2004), 69 Fed. Reg. 11126, 11179 (Mar. 6, 2004).

¹⁵ The Commission has long stated that market data fees should be set in a way that avoids cross-subsidization of an SRO’s competitive activities, and the courts have specifically approved of this objective. See *NASD, Inc. v. SEC*, 801 F.2d 1415, 1420-21 (D.C. Cir. 1986).

same terms to third parties as it does to its own subsidiary. These reforms may allow market forces to set the price for basic data from an exchange, while encouraging competition for value-added data products.

To assure meeting the Exchange Act goals of transparency and best execution for both retail and institutional investors, the Commission should also consider expanding the market data required to be provided to all investors under its Display Rule¹⁶ to go beyond the National Best Bid or Offer (“NBBO”) to include some “depth-of-book” information. Even the average retail order today is larger than the size typically reflected in the consolidated quotation, and as a result investors cannot predict at what prices their orders will be executed.

The current market data system as it has evolved is inconsistent with the requirement that market data rule filings be “not unreasonably discriminatory.” Today, the more rapidly accessible “depth-of-book” market data that exchanges provide at onerous prices is out of reach of most investors. Most investors, and the professionals who serve them, must make investment decisions on the basis of a less complete set of information that is more slowly delivered in the form of the NBBO consolidated quotes. As the chart attached at Appendix A demonstrates, a non-professional investor who seeks to obtain “depth-of-book” market data products from the major markets would have to spend over a thousand dollars a year - dwarfing the amount most investors pay in commissions. Appendix A also demonstrates that, by comparison, a firm that trades using a computer and only uses data internally without distributing it to employees pays only a single data recipient charge, although it may use that data to generate tens of thousands of trades. In further contrast, professional “subscribers” of distributed data, such as broker-dealer registered representatives, are charged substantially more for market data, when multiplied by the number of potential subscribers at a single firm. These increased costs of doing business, potentially totaling tens of millions of dollars per year for some individual firms and hundreds of millions of dollars per year across the financial markets, pose a drag on the competitiveness of the U.S. securities markets as a whole - costs that are ultimately borne by investors.

The Commission Should Grant the NetCoalition Petition and Reform the Current Market Data

System. The Commission has taken a deliberate approach to the important issue of market data since it first sought comments in a Concept Release in 1999.¹⁷ However, since this time, market and regulatory developments, discussed below, have overtaken the Commission’s deliberative process.

¹⁶ Regulation NMS Rule 602.

¹⁷ The Commission convened a Market Data Advisory Committee, which produced a majority report and a spirited dissent. The Commission sought further comment on market data issues in both its original proposal of Regulation NMS and in its reproposal. The Commission sought comment on market data again in its Concept Release on SRO Governance.

We hope our analysis in this letter will confirm that the lack of an effective check against excessive prices for market data critical to the efficient operation of our securities markets raises fundamental questions of fairness and market efficiency that the Commission needs to address in a prompt and comprehensive manner. Accordingly, SIFMA respectfully urges the Commission: (i) to reverse the Staff's order by delegated authority approving the NYSEArca's fee proposal pursuant to the Commission's Rule of Practice 431 on the grounds that the order failed to establish that the fees are fair and reasonable, (ii) to conduct a prioritized review - one that extends beyond the scope of this proceeding - of the Commission's approach to market data generally and the process and standards by which the Commission should evaluate market data fee proposals, and (iii) to impose a moratorium on reconsideration of the NYSEArca proposal or the approval of any other market data rule proposals until such an appropriate approach with consistent standards and processes is developed.¹⁸

II. The NYSEArca Filing in this Proceeding Is Deficient and the Commission Should Not Approve It.

SIFMA has explained the deficiencies in the NYSEArca filing at issue in its prior letters, and will summarize those arguments here.¹⁹ These deficiencies are not unique to NYSEArca's filing - exactly the same deficiencies apply to recent "depth-of-book" market data rule filings by other markets,

¹⁸ We note that the FDIC imposed a similar moratorium on approval of insurance applications for state-chartered industrial loan companies ("ILCs") while it reviews whether it is appropriate for non-financial firms to charter ILC subsidiaries. Federal Deposit Insurance Corporation Press Release, *Moratorium on Certain Industrial Loan Company Applications and Notices* (July 28, 2006). In defending the moratorium, the FDIC said: "The FDIC recognizes that the moratorium may appear inconsistent with specific timetables for agency action on certain applications or notices. *However, adherence to a strict statutory timeline without an opportunity to re-evaluate the FDIC's standards for determining the public interest may frustrate the substantive policies the agency is charged with promoting*" (emphasis added).

¹⁹ SIFMA filed two comment letters in this proceeding while it was being considered by the Staff of the Division of Market Regulation. Comment Letters from the Securities Industry Association ("SIA") re: SR-NYSEArca-2006-21 and SR-NYSEArca-2006-23 (NYSEArca market data fee proposal) (June 30, 2006 and Aug. 18, 2006).

SIFMA has also filed comment letters on a variety of other SRO rule changes relating to market data. See, e.g., Comment Letter from SIFMA re: SR-Amex-2006-89 (Amex Depth-of-Book Data) (Dec. 18, 2006); Comment Letter from SIFMA re: SR-NYSE-2006-81 (NYSE proposal to bundle exchange best bid and offer data with OpenBook) (Nov. 9, 2006); Comment Letter from SIA re: SR-SR-Nasdaq-2006-013 (TotalView fee proposal integrating INET) (Aug. 18, 2006); Comment Letter from the SIA (April 28, 2006), File No. SR-NYSE-2005-32 (NYSE OpenBook proposal); Comment letter from the SIA (July 18, 2005), File No. SR-NASD-2005-05 (TotalView enterprise license fee).

SIFMA and its predecessors also have addressed market data in a number of letters regarding the broader market structure issues of which market data is an integral part. See, e.g., Comment Letter from SIA and The Bond Market Association (Feb. 2, 2006), File No. SR-NYSE-2005-77, at 19-20 (NYSE combination with Archipelago); Comment Letter on Regulation NMS from Marc Lackritz, President SIA to Jonathan Katz, Secretary, SEC (Feb. 1, 2005), File No. S7-1-04, at 25-31; Comment Letter on Regulation NMS from Marc Lackritz, President SIA to Jonathan Katz, Secretary, SEC (June 30, 2004), File No. S7-1-04, at 21-28; Comment Letter on SRO Governance and Transparency Concept Release from Marc Lackritz, President SIA to Jonathan Katz, Secretary, SEC (March 9, 2005), File No. S7-39-04, at 16-19.

including Nasdaq and the American Stock Exchange, as well, and we have submitted similar comments on those filings. In sum:

- The filing does not provide any data to indicate the costs incurred by the exchange in producing this or any other market data product, nor does it relate the proposed fee increase to those costs in any way.²⁰
- The filing does not reconcile how, although Arca was able to thrive as a for-profit enterprise by giving away its “depth-of-book” market data for free as an inducement to generate trading interest, NYSEArca (a much larger entity with pricing power that Arca lacked) needs to charge substantial amounts of money for the same data. We cannot understand how such a pricing history can meet the “fair and reasonable” requirements of the Exchange Act.²¹
- The filing does not address the radical change in circumstances caused by the conversion of the NYSE from membership owned, not-for-profit status to shareholder owned, for-profit status, nor does it address the pending transfer of regulatory functions away from the NYSE.
- The filing does not address the effect of the fee on retail investors and the market professionals who serve them, despite the fact that the fee effectively will result in the elimination of access to this data for many retail investors, and despite the mandate of the Exchange Act for non-discrimination and transparency in market data.
- The filing does not reconcile how a faster single-market data feed available at a high price to a small subset of investors, while most investors and their brokers and financial advisers must rely on slower consolidated market data products, is consistent with the mandate of the Exchange Act for equal access to and transparency in market data.
- The filing does not include the contract terms governing access to and use of the market data, which constitute “policies or practices” required to be filed for Commission approval

²⁰ In its reproposal of Regulation NMS, the Commission stated: “Many commentators recommended that the level of market data fees should be reviewed and that, in particular, *greater transparency concerning the costs of market data and the fee-setting process is needed. The Commission agrees.*” Exchange Act Release No. 50,870 (Dec. 16, 2004), 69 Fed. Reg. 77424, 77461 (Dec. 27, 2004) (emphasis added). We urge the Commission to act on this observation, made over two years ago.

²¹ Nor does the NYSEArca filing comply with the requirements of Form 19b-4 that it provide a detailed and specific explanation of the burdens on competition that the filing would impose, that it specify the categories of persons and kinds of businesses on which that burden on competition will be imposed and how the filing will affect them, and that it explain why that burden on competition is necessary and appropriate in furtherance of the purposes of the Exchange Act.

under Exchange Section 19(b), nor does the filing address the administrative costs and burdens (including extensive new systems controls and audit requirements never before required for Arca subscribers) those contract terms impose.

- For the above reasons, the filing fails to meet the requirements of Exchange Act Rule (and Form) 19b-4.

SIFMA respectfully suggests that the Commission Staff's order approving the NYSEArca proposal did not adequately address the issues set forth above and would have benefited from a developed approach with consistent procedures and standards for analysis.²²

The Staff Order relied primarily on the argument that NYSEArca's fee is reasonable because it is comparable to fees already charged by NYSE and Nasdaq. But, as explained below, Nasdaq and NYSE in turn also never presented any cost data to substantiate their fees. The exchanges have government-granted exclusive access to market data for securities listed in their respective markets. Broker-dealers are required to provide trade and order information to those markets for free, and then must buy that information back from those markets. Under these circumstances, the fact that one exchange with exclusive access to data relating to its market charges a similar amount to that charged by another exchange with exclusive access to data generated in its market hardly qualifies either fee as "fair and reasonable" or "not unreasonably discriminatory." Nor does either fee have anything to do with either exchange's "cost" - the standard the Commission has advocated since at least the 1999 Market Data Concept Release.

III. The Importance of Market Data Has Evolved So that Today "Depth-of-Book" Information Is Essential for Investors and Market Participants.

Until the past decade, single-exchange market data outside the consolidated "national best-bid-and-offer" quotations was relevant to very few retail or institutional investors. So-called "depth-of-book" data is not included in the information provided by the consolidated Securities Information Processors ("SIPs"), and individual markets sell that information separately. Alternative trading systems such as INET, ARCA and BRUT gave away their "depth-of-book" information for free as a means of attracting trading interest. Historically, investors had been reluctant to post limit orders outside the prevailing quotes, for fear of disclosing to the market potentially valuable information about their intended trading strategies. However, as the Commission has recognized, with the advent of decimalization, the depth of quotes at the "inside market" has substantially decreased, and the quotes that constitute the "inside

²² Because SIFMA is the trade association for broker-dealers, and broker-dealers are required to (and do) purchase market data at the prices approved by the Commission, SIFMA has organizational standing to represent the interests of its members. See *Chamber of Commerce v. SEC*, 412 F.3d 113 (D.C. Cir. 2005); *Consumer Fed'n of Am. v. FCC*, 348 F.3d 1009 (D.C. Cir. 2003).

market” change far more frequently than before. Moreover, with the growth of automated trading and the pending implementation of Regulation NMS, “depth-of-book” quotations will more likely become executable, and therefore will be much more important. Quotes outside the inside market when posted may quickly become the inside market, and under Regulation NMS may be executed as part of “aggressively priced inter-market sweep” orders even if they are not at the inside market. An investor seeking to trade 1000 shares of a security often will see an “inside market” quote valid for only 100 or 200 shares, and therefore is unable to predict the prices at which the remaining 800 or 900 shares of the order will be executed.²³

Simultaneously, the Commission has been placing increasing emphasis on the duty of best execution. Regulation NMS itself was designed, in large part, to support the duty of best execution. The Commission and the SROs have conducted repeated examination sweeps of broker-dealers’ execution quality committees, to assure that those committees are adequately considering the execution quality data required by former Rule 11Ac1-5 (now Regulation NMS Rule 605). Similar examination sweeps have sought to assure that broker-dealers’ order routing information, required by former Rule 11Ac1-6 (now Regulation NMS Rule 606) also is accurate. Still other widely publicized examination sweeps and enforcement investigations have reviewed very particularized elements of broker-dealers’ order-routing practices, for example why some broker-dealers did not make use of a particular market’s “opening cross” methodology. On the asset management side, repeated examinations and enforcement investigations have reviewed subjects such as soft dollars, with the implicit (and sometimes explicit) message that anyone who pays more than the industry average in terms of commissions per share must not be satisfying their best execution obligations to their investors. As a result of these trends, broker-dealers and other securities market participants have become convinced that it is prudent to buy any number of single-exchange “depth-of-book” market data products that arguably could assist them in meeting their best execution obligations.

Further, several market developments have increased the importance of the speed of market data. In addition to reducing quote volume at the inside market, decimalization has greatly increased the volatility of quotes - actively traded stocks may have quote changes as often as multiple times per second. Once again, Regulation NMS places a significant premium on knowing the most current quote - otherwise a market participant risks sending an order to a market center that is unable to execute that order. Further, the process through which the SIPs consolidate quotes from different markets takes a certain amount of time (especially since the exchange administrators of the SIPs have little if any financial incentive to invest money to modernize their operations). As a result, some

²³ Thus, NYSEArca’s reported pilot program to provide real-time information about last trades, but no information about quotes (see n.3 above), does not address at all the Regulation NMS goal that investors have enough information about quotes to predict the prices at which their prospective orders will be executed or see the direction in which quotes are moving.

markets - including (as relevant in this petition) the NYSE and NYSEArca - now advertise that their unconsolidated market data products are faster than the consolidated market data feeds.²⁴ These markets (again, including the NYSE) also advertise that their market data products therefore offer better order execution opportunities than the consolidated market data feeds.²⁵ When the major SROs tell their member firms that a particular market data product facilitates better executions, those member firms understandably feel pressure to buy that market data product, regardless of their own evaluation of the merits of that product.

As a result of these trends, many broker-dealers and other market participants have come to the conclusion that it is prudent to purchase and evaluate single-market "depth-of-book" market data, at least from the major markets, so there can be no doubt they have met their duty of best execution. INET, BRUT and Arca all gave this information away for free prior to their mergers with (respectively) Nasdaq and the NYSE. Today, all of these ATs are "integrating" this "depth-of-book" data with the costly "depth-of-book" market data products offered by Nasdaq and the NYSE. As a result, important "depth-of-book" data which was previously available to all investors now will be only available to market professionals or institutions who may feel it prudent to purchase expensive subscriptions - costs that are ultimately borne by investors.²⁶

IV. Changes in Self-Regulation Require the Commission to Exercise Greater Oversight of Market Data Fees

For the first twenty-five years after the passage of the 1975 Act Amendments, the SROs were not-for-profit, membership owned institutions with both marketplace and regulatory functions. The SROs had

²⁴ The NYSE's "ArcaBook – Fee Transition Fact Sheet" states (emphasis added):

The ArcaBook data feed provides real time, depth of book limit order information for NYSE Arca and ArcaEdge (OTCBB). By receiving the information directly from the source, ArcaBook clients are able to receive order information *approximately 60 times faster than they can through the securities information processor (SIP)* and see 6 times the liquidity within five cents of the inside quote that is offered by the market inside.

²⁵ As the NYSE's prospectus stated: "NYSEArca's market data products are designed *to improve trade execution.*" *NYSE Group, Inc. Form S-1* at 122 (filed March 13, 2006) (emphasis added).

²⁶ SIA's June 30, 2004 comment letter on Regulation NMS suggested that while NBBO market data should be provided at cost, "non-core data such as depth-of-book" could be priced "subject to market forces." However, today, in a decimalized, Regulation NMS environment, "depth-of-book" *is* "core data" which many broker-dealers feel it is prudent to analyze in connection with best execution duties and Regulation NMS order-routing obligations. Today there are no effective "market forces" that constrain exchanges in pricing "depth-of-book" data available only from one source for each exchange. By the time of its Feb. 1, 2005 comment letter on the reproposal of Regulation NMS, SIA noted the value of the NBBO was decreasing. For the last two years, SIA has consistently advocated that a cost-based standard should be applied to "depth-of-book" market data products from Amex, NYSE and Nasdaq because of their implications for best execution, Reg NMS compliance and fairness to all investors.

no responsibility to maximize their profits, and their member ownership exercised at least some brake on the fees they could charge. Formerly, the SROs argued that market data revenues should subsidize not only the consolidation and dissemination of market data itself, but also their regulatory functions. All of these basic assumptions have now changed - but the Commission's review of market data rule proposals has not kept pace. Today, all of the major US securities markets are for-profit enterprises with a fiduciary duty to maximize profits for their shareholders. Broker-dealers who conduct trading on the exchanges no longer have any guaranteed voice in the management of those exchanges. If, as for market data, the broker-dealers are obligated as a regulatory matter to purchase a product from those exchanges, then there is no source of market discipline to assure that the price for that product is "fair and reasonable." The Commission itself concluded *more than seven years ago* that, with for-profit exchanges, "closer monitoring of the SRO's funding and internal allocation of resources will be necessary" and observed:

the fees charged by a monopolistic provider of a service (such as the exclusive processor of market information) need to be tied to some type of cost-based standard in order to preclude excessive profits if fees are too high or underfunding or subsidization if fees are too low. The Commission therefore believes that the total amount of market information revenues should remain reasonably related to the cost of market information.²⁷

The exchanges' argument that market data revenues are necessary for regulatory functions has been made with respect to consolidated market data, not single-exchange "depth-of-book" products. NYSEArca has never sought to justify the fees to be collected as a result of the proposal at issue here on the ground that it was necessary to pay for any regulatory functions - the fee is intended solely to increase returns for its shareholders.²⁸

²⁷ Market Data Concept Release, Exchange Act Release No. 42,208 (Dec. 9, 1999) at text accompanying note 119.

²⁸ We do not object to exchanges creating value-added data analytics tools and pricing them at whatever the market will bear, but only if the underlying data stream is available on equal and non-discriminatory cost-based terms. However, we are very concerned by any attempt to leverage an exchange's control over market data to create a competitive advantage for such data analytics products, as we believe is the case for Nasdaq's use of regulatory data to produce competitive commercial products. Letter from SIA re: SR-NASD-2006-056 (Market Analytics Package); SR-NASD 2006-072 (Trading and Compliance Data Package) (July 14, 2006). NASD designated this rule change as "non-controversial" and therefore immediately effective under Rule 19b-4(f)(6), despite adverse comments from SIA, NetCoalition and others. The Commission had made an express policy determination only a few months earlier to deny Nasdaq similar use of OATS data for "non-regulatory purposes." See Exchange Act Release No. 53,128 (January 13, 2006) at text after n.136. The problem of exchanges seeking to "tie" their regulatory services to other products where they face competition is not limited to market data, as evidenced by Nasdaq's proposal to tie its listing fees to public companies' use of Nasdaq's shareholder communication services. See Exchange Act Release No. 54,752 (Nov. 14, 2006). We urge the Commission to be vigilant in preventing such improper uses of exchanges' regulatory functions to benefit their competitive products.

Moreover, with the impending merger of the NASD and NYSE Regulation, the vast majority of the regulatory functions formerly provided by the exchanges will move to a separate organization.²⁹ SIFMA is committed to full and adequate funding for the new regulatory entity - and SIFMA would support a regulatory fee levied on broker-dealers to provide this funding.³⁰ However, the costs of the new industry self-regulator should be transparent and subject to public review - which is not consistent with being paid out of market data revenues.

The result of the current system of market data rule proposals has been to defeat the National Market System goal of transparency: the fastest, most informative market data is not available to most investors or the market professionals who serve them. The path to reconciling the goals of the Exchange Act - effective industry self-regulation along with widely accessible transparent market data - is for market data fees to be set on a cost basis, and for self-regulation to be funded by other fees.

V. The Economics of Market Structure for Exchange Market Data Products Have Changed, and those Economics Now Require Heightened Scrutiny by the Commission

SIFMA respectfully asks the Commission to consider the unique context of the market structure in which the for-profit exchanges are now operating. When an exchange acts as the exclusive processor of securities pricing data on its market, only it can aggregate that information to show the true depth and quality of the market for the securities that trade on that exchange. Thus, only the exchanges selling this data have knowledge about the true depth and quality of their own liquidity. Investors and other market participants cannot accurately place a value on an exchange's data product without seeing it, which they cannot do unless they are willing to buy it.

This information and access asymmetry between the exchange and investors and other market participants regarding the "value" of the market data products results in what economists call a market failure. Fair pricing based on "value" does not work in such circumstances. Because each exchange sets the fees for the data which it controls, it is also not meaningful to use one exchange's fees as a benchmark to measure the fairness and reasonableness of another exchange's fees.

²⁹ We recognize that a few market-specific regulatory functions such as trading surveillance will remain with the exchanges. SIFMA believes these remaining exchange regulatory duties should be funded by trading or listing fees or a separate regulatory fee, not by market data. But in any event, the exchanges currently receive market data revenues that dwarf their few remaining regulatory costs. Even if the Commission determined that market data fees should fund some of these regulatory costs, the result should be a significant decrease in market data fees - not the increase proposed here.

³⁰ SIFMA stated its support of a regulatory fee (rather than market data revenues) to fund regulatory costs in comment letters on Regulation NMS and the SRO Governance Concept Release. Comment Letter on Regulation NMS from Marc Lackritz, President SIA to Jonathan Katz, Secretary, SEC (June 30, 2004), File No. S7-1-04, at 23; Comment Letter on SRO Governance and Transparency Concept Release from Marc Lackritz, President SIA to Jonathan Katz, Secretary, SEC (March 9, 2005), File No. S7-39-04, at 15.

It has been argued that competition in the market for liquidity and resulting transaction business can serve as a constraint on what even the largest exchanges are able to charge for visibility into the liquidity on their trading platforms. However, the consolidations of NYSE with Archipelago and Nasdaq with INET and BRUT have limited that competitive constraint. These consolidations reduced competition for liquidity and thereby increased the “network effect” that the larger concentrated pools of liquidity produce, allowing the for-profit NYSE and Nasdaq to charge for market data that the electronic trading platforms had offered for free as a means of attracting liquidity when they were independent firms competing against NYSE and Nasdaq.³¹ This enhanced “network effect” in turn makes it more difficult for new competing start ups to attract enough orders to reach the critical mass of orders that would produce a liquid market of their own sufficient for their market data to have significant value.

The NYSE and Nasdaq consolidations have also produced economies of scale and scope, which can be a benefit if the resulting cost savings from increased efficiencies are passed through to investors and other purchasers of the exchanges’ products. The sunk costs of the exchanges’ substantial investments in the technological infrastructures needed to facilitate transactional activity at their market centers can be spread out over a larger user base. There are also significant economies of scope between the provision of a liquidity-rich venue for transactional activity that is the main product of the exchanges and the gathering and dissemination of information generated as a by-product of that transactional activity which is turned into a discrete product offering. The fixed costs of the exchanges’ systems to distribute data are relatively insensitive to the number of market data products that are offered by online access.³² Indeed, the additional cost of re-distributing data within a broker-dealer or externally to its customers (including capacity costs) is borne by the broker-dealer, not the exchange.

Unfortunately, instead of passing through the efficiency benefits of increased economies of scale and scope resulting from the NYSE/Arca and Nasdaq /INET/BRUT mergers, the exchanges have used the consolidations as a means to increase their market power in the sale of the information by-products from the transactional activities on their platforms. Market data rule proposals have been routinely

³¹ The network effect is a characteristic that causes a service to have a value to a potential customer dependent on the number of other customers already using that service. One consequence of a network effect is that the purchase of a service by one individual indirectly benefits others who use the service - for example by purchasing telephone service a person makes other telephones more useful. This type of side-effect in a transaction is known as an externality, and externalities arising from network effects are known as network externalities. The ability of a financial market to attract liquidity is a leading example of a network effect, and the potential abuse of network effects is a primary focus of modern competition analysis.

³² Unfortunately, as discussed above, in this case NYSEArca has used its economies of scale to make its single-exchange market data product more attractive than the consolidated market data for the same securities, by (according to its own claim) making the single-exchange product sixty times faster than the consolidated product.

approved by the Commission staff under its delegated authority without any economic analysis, including new charges for access to market data that the companies which were acquired by NYSE and Nasdaq had offered for free before the mergers.

In its most recent 10-K filing with the SEC, Nasdaq summed up the rationale for the Nasdaq and NYSE acquisitions this way: "As equity exchanges have demutualized and become for-profit public companies, they have focused on achieving economies of scale, improved technology and greater profitability through acquisitions. Recent acquisitions have resulted in the original entrepreneurial ECN entrants being absorbed by other players."³³ Subsequent 10-Q filings demonstrate that for Nasdaq (which we believe is reasonably representative of other exchanges), market data revenues exceed the total amount they spend on technology to run its entire business - and the market data revenues are increasing at a much greater pace than the technology expenditures. Nasdaq's latest financial report for the three months ending on September 30, 2006 demonstrates how its larger size operations, due in large part to its consolidation with INET, has permitted it to realize dramatically greater net revenues from market data while actually decreasing its spending on technology-related expenses.³⁴

As discussed above, the NYSE Group likewise attributed its revenue growth in market data "*primarily to the contribution of NYSEArca's operations*, following the completion of the merger between the NYSE and Archipelago on March 7, 2006."³⁵ The NYSE Group's reported market data segment revenues totaled \$57.5 million in the third quarter of 2006: up 33.7% from the same three month period in 2005.³⁶ The NYSE's revenue from single-exchange market data products (such as the one

³³ *The Nasdaq Stock Market, Inc. Form 10-K for the fiscal year ended December 31, 2005* (filed March 15, 2006).

³⁴ *Nasdaq Form 10-Q for the quarterly period ending Sept. 30, 2006; Nasdaq Press Release, NASDAQ Announces Third Quarter 2006 Results* (October 19, 2006). Nasdaq's net income as a whole nearly doubled year-to-year between the third quarter of 2005 and the third quarter of 2006, benefiting from a 48.8% growth in net revenues from execution, trade reporting and related services including market service subscription revenues. Nasdaq reported \$38.6M of net market service subscription revenues, approximately 22% of Nasdaq's total net revenues for that period. About half of Nasdaq's market service subscription revenues (\$18M) came from the sale of its single-exchange market data products. In the comparable three month period ending September 30, 2005, the total net market service subscription revenues were \$27.2M, a third of which came from single-exchange products (\$9M). On the expense side for Nasdaq, the total of depreciation, amortization, computer operations and data communications came to \$23.8M for the three month period ending on September 30, 2006. These expenses totaled \$29M for the comparable period in 2005. The depreciation and amortization line item captures recognition of amortized capitalized costs for property, equipment, significant purchased application and operational software and internally developed software. If one were to charge all of the depreciation, amortization, computer operations and data communications expenses incurred for all of Nasdaq during Q3 2006 against the market data revenue, there would be a surplus of \$14.8M (a swing from a \$2M deficit one year earlier).

³⁵ NYSE Group, Inc. Form 10-Q for the quarterly period ending Sept. 30, 2006 (emphasis added).

³⁶ *Id.* Expenses for the market data segment grew by only 23.1% in the same time period.

at issue here) grew by 24% in 2005, the last year for which such information is available.³⁷ Its pre-tax margin grew from 7.5% during the third quarter of 2005 to 23.6% during the third quarter of 2006.³⁸

In short, market data revenues are growing far faster than inflation, and far faster than any comparable costs the exchanges are incurring. By deciding to charge for the ArcaBook data covering transactional activity taking place on the NYSEArca market, the NYSE Group is using its market power enhanced by the consolidation to wring more money out of investors for data that Archipelago had offered for free before the merger. The result is less transparency for investors, which is contrary to the national market system goals of Section 11A.

VI. The Commission Should Ensure Fair and Reasonable Prices for Market Data

A. The Commission Should Adopt a Cost-Based Standard for Review of Exchanges' Market Data Rule Filings.

As the Commission itself noted in the Market Data Concept Release more than seven years ago, a world with for-profit exchanges requires the Commission to intervene to ensure fair and reasonable prices for market data which the exchanges control. Indeed, "fair and reasonable," "not unreasonably discriminatory" and "equitable allocation of costs" are the standards the Commission has been required to apply ever since 1975. Because each exchange today operates as an exclusive processor of data, neither reliance on competitive market forces alone nor use of price comparisons among the exchanges will work as barometers of a fair and reasonable price. Thus, the Commission needs to consider other alternatives in exercising its regulatory authority.

The cost of collecting, consolidating and distributing the data, over and above what the exchanges would have to spend anyway in order to attract the liquidity to their trading platforms, is the obvious factor to consider. "[W]hen the inquiry is whether a given rate is just and reasonable to the consumer, the underlying concern is whether it is *low* enough so that exploitation by the producer is prevented ... [N]o factors apart from producers' costs are available to guide efforts to make that determination from the standpoint of the consumer." *City of Chicago v. FPC*, 458 F.2d 731, 751 (D.C. Cir. 1971), *cert. denied*, 405 U.S. 1074 (1972) (emphasis in original).³⁹

³⁷ NYSE Group, Inc. Form 8-K filed November 16, 2006, Exhibit 99.1 - presentation at the Merrill Lynch Banking & Financial Services Conference slide 6.

³⁸ *Id.*

³⁹ We recognize that historically the Commission has hesitated to take a utility/ratemaking approach to the issue of market data, even though it has long characterized the exclusive processors as industry utilities. With respect to "depth-of-book" data today, each exchange is operating as an exclusive processor. Perhaps when members of the securities industry and representatives of the public governed SRO boards, and when SROs had not-for-profit status, the Commission could reasonably rely on those governance mechanisms to provide checks against the abuse of what the Commission itself has long characterized as monopoly pricing power. However,

The Commission has repeatedly stated that it endorses a “cost-based” approach to market data, since at least the Market Data Concept Release.⁴⁰ Indeed, the Commission has stated that to meet the statutory test of being “not unreasonably discriminatory,” a market data rule proposal must provide for an “equitable allocation of costs” - which confirms that “cost” is the appropriate standard for evaluation of market data fees.⁴¹ Yet to date the Commission has not yet actually adopted a “cost-based” approach. The analysis of the Staff in the Order now under review, which merely compared the NYSEArca fee to that charged by other exchanges, has nothing to do with cost. We urge the Commission finally to go forward with a “cost-based” approach, and to require the Staff to use that approach in connection with all future market data rule proposals.⁴²

A “cost-based” approach would require the exchanges to identify and substantiate their market data costs in their market data rule filings - something NYSEArca entirely failed to do in this case. This could be accomplished by adopting a new “Form Market Data,” as discussed below. Such a form would require the exchanges, when proposing an increase in market data fees, to identify how and why their market data costs had increased, to estimate the revenues from the proposed fee increase, and to explain why the proposed increase is justified in light of the exchange’s market data costs. Again, NYSEArca entirely failed to perform this analysis in this case. Finally, such an analysis would require the exchange to file for approval not only the amount of its fee but also all the other material relevant to the fee, including the contract provisions it intends to apply, the systems specifications, and the audit requirements, so that the industry and the investing public will have notice of and can comment on, and the Commission can evaluate, the costs, benefits and burdens of the proposal as a

today, when those governance checks no longer exist and exchanges are for-profit entities with a fiduciary duty to shareholders to maximize profits, the Commission can no longer ignore the exchanges’ inherent conflict of interest when pricing their market data. The Commission has no choice but to exercise the power that Congress clearly gave it in the 1975 Act Amendments to exercise substantive review of the levels of market data fees set by the exchanges. Indeed, under the current circumstances, the Commission’s duty to assure that market data fees are “fair and reasonable” and “not unreasonably discriminatory” demands no less.

⁴⁰ In the *Instinet* proceeding, the SEC imposed a cost-based restriction on an NASD market data fee, and the courts upheld this approach as consistent with the “fair and reasonable,” “not unreasonably discriminatory” and “equitable allocation of cost” standards. See *NASD, Inc. v. SEC*, 801 F.2d 1415 (D.C. Cir. 1986).

⁴¹ See, e.g. Market Data Concept Release, Exchange Act Release No. 42,208 (Dec. 9, 1999) at text accompanying note 142.

⁴² Once the Commission has adopted a cost-based approach, we believe it would also be appropriate to review existing market data rules in light of that approach, and if necessary abrogate past market data fee increases that would not satisfy a cost-based standard. In the case of market data rules where abrogation is not available, the Commission should address the rules in a way that will bring them into compliance, either through requesting that the SROs not enforce them until they have been refiled in accordance with the principles the Commission articulates, including as to cost and competitive issues, or through other action as the Commission may deem appropriate.

whole.⁴³ Once again, in the proceeding, NYSEArca completely failed to address these issues in its market data rule proposal.

B. The Commission Should Define “Cost” to Mean the Cost of Collecting, Consolidating and Distributing Market Data, and Should Not Include Other Unrelated Costs

Of course, to adopt a cost-based approach, the Commission must decide what is a “cost” appropriately attributable to market data. We urge a straight-forward answer to the question: the cost to an exchange of market data is the cost to that exchange of collecting, consolidating and distributing market data - and nothing else.⁴⁴ Other costs, such as the cost of market and member regulation (costs that will shortly move to a separate SRO) and the cost of market surveillance (which will remain at the exchanges), should be funded by listing fees, trading fees and regulatory fees - but not by market data fees. These other SRO costs are legitimate and necessary, and it is critically important that they be funded at an appropriate level. The broker-dealer community represented by SIFMA stands ready and willing to pay a regulatory fee to cover an appropriate portion of these costs, as SIFMA and its predecessors have publicly stated for at least the last three years. However, it defeats the National Market System goals of transparency and non-discrimination to fund those regulatory activities through market data fees, with the current result that most investors and their market professionals receive slower data of lower quality than they should have available.

The Commission can and should resolve the NYSEArca market data rule proposal by deciding that NYSEArca has not submitted adequate information to demonstrate that the proposal is cost-justified, using the standard we have suggested in this letter. However, as discussed in the following sections, we believe the Commission should consider additional reforms for the market data system.

C. The Commission Should Reconsider the Process for Exchanges’ Market Data Rule Filings

We recommend that the Commission adopt a specialized form for market data rule filings that requires a detailed justification of the proposed fee change. Such a discussion would include a substantiation of the exchange’s historical costs in producing market data, its current market data revenues, how and why the costs have changed and the existing revenue is no longer appropriate, the amount of the

⁴³ The important issue of the costs and burdens on market data subscribers is discussed further below in Section VI.D.

⁴⁴ Of course, in addition to recovering its costs, it is fair for exchanges to receive a reasonable rate of return on their investment in producing market data products - but that rate of return should recognize the extremely low risk exchanges run in providing an exclusive product with a captive audience that believes it must purchase that product.

proposed fee and how it differs from the existing fee, how the fee change will impact different market participants, how the fee change will impact revenues, how those revenues will be used, and what contract terms, systems specifications and audit requirements will be associated with the fee change. We also suggest that the Commission require the exchanges to file with the Commission information at least annually concerning their market data costs and revenues, so that the Commission and the public can evaluate whether existing fees remain appropriate.⁴⁵

Further, we believe the current system by which many market data rule changes are deemed “effective upon filing” under Rule 19b-4(f) should be reconsidered. As we have demonstrated above, in the current environment of for-profit exchanges, market data rule filings present significant policy issues involving the potential for serious adverse consequences on market transparency and competitiveness. These filings should not be treated like restatements of existing policies and procedures, rule changes that merely affect exchange administration, or minor rule changes that do not affect the protection of investors or the public interest and do not impose significant burdens on competition. Market data rule proposals should all be subject to notice and comment before being approved. Moreover, the public should have at least a full thirty-day opportunity for the notice and comment process on these filings, rather than the twenty-one day period now often used for such filings.

As noted above, news reports indicate that NYSEArca may propose a pilot program to provide real-time last sale data (but not any quote data, much less “depth-of-book” data) to financial portal websites.⁴⁶ The Commission’s review of the current market data structure should include the use of such pilot programs. Exchanges have sometimes offered pilot programs to some subscribers but not others, which we believe raises serious issues about fairness and non-discrimination. While some pilot programs have been filed with the Commission for approval, others have not: we believe all pilot programs should be subject to Commission approval under Section 19(b). In general, we believe the proliferation of market data pilot programs have contributed to making the market data structure as a whole less transparent and more discriminatory for market participants.

⁴⁵ We note that in the proposed SRO governance rules, the Commission proposed a Rule 17a-26 and a Form 1 to obtain comprehensive quarterly financial information from the SROs concerning market data and other operations.

⁴⁶ Aaron Lucchetti, *NYSE Test May Give Investors Real-Time Quotes Via the Web*, Wall St. J. (Jan. 12, 2007) at C3. We understand Nasdaq also has submitted a proposal (not yet published) concerning real-time access to last sale data, without information about quotes. While potentially useful to some investors, real-time last-sale data without information about quotes is not sufficient for investors or broker-dealers to make judgments about orders they are considering whether to enter, either for the purposes of seeking best execution or for order routing under Regulation NMS.

D. The Commission Should Review All of the Information Relevant to Market Data Filings, Including the Costs and Burdens on Subscribers.

Most market data rule filings, like NYSEArca's filing here, focus only on the amount of the fee. However, those filings can impose significant costs on subscribers (such as broker-dealers) beyond the amount of the costs. Market data rule filings almost never include the contract terms to which subscribers must agree in order to receive those market data products. Those contract terms often include onerous terms.⁴⁷ For example, broker-dealers may be required to obtain further contract agreements with their own customers for the benefit of the exchange, before the broker-dealer can provide market data to those customers. The exchanges' contracts typically impose onerous and costly audit requirements on subscribers such as broker-dealers. The contracts contain vague and confusing definitions of "users" and "devices" that the exchanges then may interpret in arbitrary and counter-intuitive ways (such as charging multiple times for a single user who accesses market data through multiple channels), but as to which the broker-dealers and other subscribers have no effective recourse. The exchanges' contracts impose exceptionally broad indemnification requirements that shift substantial risks from the exchanges to the subscribers. The contracts often prohibit broker-dealers from deriving downstream uses of data from the exchange's feed that might compete with the exchange's products (or require substantial additional fees if they do so).

We would like to make several points about these market data contract terms. First, the contract terms on which market data is to be made available should be filed with the Commission for public notice and comment, along with the fee itself. Second, when considering the reasonableness of a market data fee, the Commission should consider the costs of compliance with the contract terms in addition to the cost of the fees themselves: those compliance costs may have additional significant effects on the efficiency and transparency of the markets. Third and perhaps most significantly, these contract terms are effectively non-negotiable: the exchanges have no incentive to negotiate (and generally do not do so) because they know that the broker-dealers and other subscribers have no alternative from which to get that market data. The dynamics of market data contract negotiations are another example of why the Commission must exercise thorough and careful oversight of the market data structure: it cannot rely on competitive market mechanisms because today there is no competitive market for this data.

As noted above, the exchanges are using data (bids, offers, and customer orders) for commercial gain that broker-dealers submit to them in their self-regulatory capacity under the Quote Rule, Regulation NMS Rule 601. To counter this conflict of interest and the unequal bargaining power that results from

⁴⁷ For example, the terms of the CTA agreements were last filed with and reviewed by the Commission in the early 1990s. The terms of those agreements need to be reconsidered in light of the significant changes in market structure and SRO structure since that time.

operation of the Commission's rule, the Commission could require as part of any market data fee filing a representation that the exchange has received a license from the broker-dealers to use the data within the market data product. The licensing process would enable broker-dealers to address contract, administrative burden, and pricing issues before they even reach the Commission for review.

Finally, we believe the current situation in which the exchanges can and do threaten enforcement action for good faith errors in data collection or disagreements in contract interpretation also constitutes a conflict of interest. Similarly, exchanges should not be able to threaten to deny a broker-dealer access to its market data products because of errors in data collection or disagreements in contract interpretation: a broker-dealer would be at a severe competitive disadvantage if it lost access to those products, and Commission review of a denial of access petition is not an adequate or timely remedy for such a competitive harm. The current situation impermissibly mingles the exchanges' profit-driven business imperatives with their regulatory and enforcement obligations - this is yet another reason why market data operations should be moved to a separate and independent subsidiary.

E. The Commission Should Consider Structural Changes at the Exchanges to Address the Conflicts of Interest Inherent in the Current Market Data Structure

As the Commission has recognized since the Market Data Concept Release in 1999, for-profit exchanges have an inherent conflict of interest in pricing and distributing market data. The largest exchanges in particular have an inherent incentive to impose the highest possible fees, unconstrained by competitive market forces, on investors and their captive customer-base of broker-dealers who have no other place to turn for access to the "depth-of-book" data generated by transactions in securities listed on those exchanges. Moreover (and of equal concern), they have an inherent incentive to under-invest in market-wide utilities (such as CTA or OPRA) that benefit other markets, and to invest instead in single-exchange market data products. It is for this reason that we see NYSEArca advertising that its single-exchange "depth-of-book" market data product (at issue here) is sixty times faster than the consolidated market data product available to most investors. Even under a "cost-based" approach, exchanges will have an irresistible incentive to charge unrelated costs to their market data operations, where they are guaranteed a market rate of return free from competition.

We urge the Commission to adopt a structural solution to these structural problems. We suggest requiring at least the major exchanges such as NYSE and Nasdaq to conduct their market data operations in a separate, not-for-profit market data subsidiary (much like the not-for-profit subsidiaries or divisions some exchanges use for regulatory activities). The Commission insisted on a similar structural solution when Nasdaq bought an order-management system (FSI). In that proceeding, the Commission was concerned that Nasdaq could use its market data control to leverage competitive

acceptance of the order-management system - exactly the type of potential conflict of interest that pervades the current market data system.⁴⁸ Similarly, the Commission insisted that TRACE and MSRB bond transaction reporting be placed in not-for-profit entities (the NASD and MSRB, respectively) which have an incentive to keep the fees for bond transaction data as low as possible. The purpose of the Commission's regulatory choice was to provide maximum transparency for bond trading data. Placing exchange market data in a separate, not-for-profit subsidiary would assist the Commission in segregating legitimate, properly recoverable market data costs from impermissible hidden subsidies designed to assist the exchanges' competitive activities.

Finally, we suggest requiring that exchanges make raw market data available to third parties (such as private market data vendors) on the same terms they make it available to their own market data subsidiaries and to the independent SIP. In this way, the Commission may encourage competition in providing market data products and services (including value-added services such as order analytics), and thereby provide incentives for both innovation and efficiency for the benefit of investors. We believe with this set of structural reforms to encourage competition, the Commission's burden of engaging in utility/rate-setting regulation might be reduced.

F. The Commission Should Consider Expanding the Current NBBO Data Made Available through the Consolidated Quote

Finally, we urge the Commission to consider increasing the quality and speed of the consolidated quote information provided to all investors under the Display Rule. Until the advent of decimalization, typically thousands of shares were available on both sides of the market at the "inside quotes." Today by contrast, as discussed above, often only 100 shares (and frequently only a few hundred shares) are available for purchase or sale at the NBBO. As a result, even for a retail investor considering a 1000 share order, the NBBO does not provide enough information to allow the investor to predict at what prices his or her order is likely to be executed, or to see which way quotes may be moving. This situation may place investors without access to "depth-of-book" data at a trading disadvantage to those with that access. As a result, the Commission should consider expanding the information available to all investors through the Display Rule to include some "depth-of-book" information. Moreover, at a minimum, the Commission should not allow the exchanges to exploit a regulatory anomaly and distribute their direct data in advance of the consolidated quote, so that a few investors are able to see and act on liquidity before other investors are even aware of that liquidity.

⁴⁸ See Exchange Act Rel. No. 44,201 (April 18, 2001). See also George A. Hay & Erik R. Sirri, *Discussion Paper: Competition, Transparency and Equal Access to Financial Market Data* (Sept. 24, 2002) (advocating structural separation of SIP functions from exchanges).

There are several possible ways the Commission could expand the information available through the Display Rule. The NBBO could be expanded to include the first three tiers of order interest on each side of the market. The NBBO could be redefined to require display of a certain volume amount (such as 5,000 shares) of order interest on each side of the market, no matter how many tiers of prices this required. Or the NBBO could be redefined to require display of a certain dollar amount (such as \$50,000) of order interest on each side of the market, again no matter how many tiers of prices this required. Any of these alternatives would return retail investors and the market professionals who serve them to the situation before decimalization - they would regain the ability to see the prices at which retail-sized orders will be executed without having to subscribe to multiple expensive separate single-exchange "depth-of-book" market data products.

The current situation, in which most investors and their brokers or financial advisers cannot predict the prices at which their orders will be executed, but a few investors have access to sophisticated "depth-of-book" information (and get that information more quickly to boot), is simply incompatible with the National Market System mandate of Section 11A for transparency and non-discrimination. Moreover Regulation NMS cannot achieve its aim of encouraging order interest if most investors and their brokers or financial advisers cannot even see the markets (or the portions relevant to their orders) on the same terms as the few investors who can afford single-exchange "depth-of-book" market data products. For all of these reasons, we believe it is imperative for the Commission to use the opportunity of the NetCoalition petition to reform the current market data system.

Conclusion

Accordingly, SIFMA respectfully urges the Commission: (i) to reverse the Staff's order by delegated authority approving the NYSEArca's fee proposal pursuant to the Commission's Rule of Practice 431 on the grounds that the order failed to establish that the fees are fair and reasonable, (ii) to conduct a prioritized review - one that extends beyond the scope of this proceeding - of the Commission's approach to market data generally and the process and standards by which the Commission should evaluate market data rule proposals, and (iii) to impose a moratorium on reconsideration of the NYSEArca proposal or the approval of any other market data rule proposals until such an appropriate approach with consistent standards and processes is developed.

SIFMA appreciates the interest of the Chairman, the Commissioners and the Staff in the important topic of market data. We stand ready to provide further input concerning this topic to the Commission and the Staff. If you have any questions or would like to discuss any of these issues further, please contact me, or SIFMA's Vice President and Associate General Counsel Ann Vleck, or SIFMA's Assistant Vice President and Assistant General Counsel Melissa MacGregor, all at (202) 434-8400, or our outside counsel on this matter, W. Hardy Callcott of Bingham McCutchen LLP, at 415-393-2310.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Ira D. Hammerman". The signature is fluid and cursive, with a large initial "I" and "H".

Ira Hammerman

Senior Managing Director and General Counsel

cc: Chairman Christopher Cox
Commissioner Paul S. Atkins
Commissioner Roel C. Campos
Commissioner Kathleen L. Casey
Commissioner Annette L. Nazareth
Director Erik R. Sirri, Division of Market Regulation
Deputy Director Robert L.D. Colby, Division of Market Regulation
Associate Director David Shillman, Division of Market Regulation

Appendix A: Fees for Major “Depth-of-Book” and NBBO Market Data Products

	Non-Professional	Professional	Firm (Variable Fees for Access/ Distributor)
NYSEArca ArcaBook ⁴⁹	\$10/month/device, \$120/year/device	\$30/month/device, \$360/year/device	\$750/month, \$9,000/year
NYSE OpenBook (excludes Level 1 charges)	\$60/month/device, \$720/year/device	\$60/month/device, \$720/year/device	\$5,000/month, \$60,000/year
Nasdaq TotalView and OpenView (includes Level 2 but excludes level 1 UTP)	\$14/month/device, \$168/year/device	\$70/month/device, \$840/year/device	\$5,000/month, \$60,000/year ⁵⁰
Amex Depth-of-Book ⁵¹	\$10/month/device, \$120/year/device	\$20/month/device, \$240/year/device	\$2,000/month, \$24,000/year
CTA Tape A ⁵²	\$1/month/subscriber, \$12/year/subscriber	\$127.25/month/subscriber, \$1527/year/subscriber	\$1,450/month, \$17,400/year
CTA Tape B	\$1/month/subscriber, \$12/year/subscriber	\$30.20/month/subscriber, \$362.40/year/subscriber	(covered by CTA Tape A fee)
Nasdaq Level 1	\$1/month/subscriber, \$12/year/subscriber	\$20/month/subscriber, \$240/year/subscriber	\$3,750/year
OPRA ⁵³	\$1/month/subscriber, \$12/year/subscriber	\$20/month/subscriber, \$240/year/subscriber	\$1,000/month, \$12,000/year
Annual Total for Investor to Access All Relevant Data	\$1,176	\$4,529.40	\$186,150

⁴⁹ The ArcaBook fee is split - half for access to data on CTA securities and ETFs; and half for Nasdaq-UTP securities. The data in the table assumes a customer wants access to both feeds.

⁵⁰ The Nasdaq firm fee is split, half for access, and half to serve as a distributor.

⁵¹ The Amex firm charge is based on direct access; slower indirect access costs 25% less.

⁵² CTA Tape A professional and non-professional fees both decline with volume; firm fee is based on direct access; slower indirect access costs 50% less.

⁵³ The OPRA firm charge is based on direct access; slower indirect access costs 40% less. The table does not include single-exchange “depth-of-book” market data products for the options markets (such as CBOE’s \$5/month/user non-professional fee).

Appendix B

Congress and the SEC Have Regulated Market Data with the Goal of Ensuring Transparency through Equal Access to High-Quality Market Data

The Commission's regulation of market data arises out of the National Market System portions of the 1975 Act Amendments, which were, before the Sarbanes-Oxley Act, the most comprehensive revision of the federal securities laws since the major securities laws were first adopted. As noted above, Section 11A(a)(1)(C)(iii) makes high quality market data one of the critical goals of a National Market System. Section 11A(b) creates a new type of regulated entity, a securities information processor ("SIP") to collect, process, distribute and publish market data. Section 11A(c) requires SIPs to file their plans for the collection, processing, distribution and publication of market data with the Commission for approval, as well as any amendments to those plans. Section 11A(c)(1) provides specific criteria that the Commission must consider before approving those plans, or amendments to those plans. As relevant here, Section 11A(c)(1)(B) requires that the plans "assure the prompt, accurate, reliable, and fair collection, processing, distribution and publication of [market data] and the fairness and usefulness of the form and content of such information." Section 11A(c)(1)(C) requires that the plans provide market data "on fair and reasonable terms." Section 11A(c)(1)(D) requires that the plans make market data available to "exchange members, brokers, dealers, [other SIPs], and . . . all other persons" on terms which "are not unreasonably discriminatory." Sections 11A(c)(1)(E) and (F) require that broker-dealers transmit orders in a way consistent with establishment of a national market system, and require "equal regulation" of all markets and all broker-dealers. Section 3(a)(22)(B) recognized that any SIP engaged in collecting, processing and distributing market data on an exclusive basis with an exchange would be an "exclusive processor" which would, because of its potential for abuse of this control position, have to be subject to additional regulation.

Although the 1975 Act Amendments did not require that the exchanges set up exclusive SIPs for the distribution of consolidated information about the NBBO for securities, that is in fact what happened, and what the Commission approved. The Consolidated Tape Association ("CTA"), managed by the New York Stock Exchange, provides consolidated market data for exchange-listed securities.⁵⁴ Nasdaq provides consolidated market data for Nasdaq-listed and over-the-counter securities. After the introduction of exchange-traded options, the Options Price Reporting Authority ("OPRA"), managed by the CBOE, provides consolidated market data for options. Each of these exclusive SIPs has a monopoly on market data in its area. Every equities exchange is a member of CTA and participates in Nasdaq's SIP function; every options exchange is a member of OPRA. As a result, no exchange has any interest in establishing

⁵⁴ Since its beginning, the CTA has had two sets of market data fees: Tape A fees for NYSE-listed securities, and Tape B fees for American Stock Exchange-listed securities.

a competitive SIP in any of these markets. Each exchange has also established exclusive processors for the sale of “depth-of-book” market data collected on and distributed by that exchange.

Congress recognized the dangers of exclusive processors, both for single-exchange market data, and for consolidated market data. It indicated that they should be regulated as public utilities and urged the Commission to guard aggressively against all manner of abuse, pointing to the risk of anti-competitive behavior if such regulation were not effectively applied:

[S]erious antitrust questions would be posed if access to this facility and its services were not available on reasonable and nondiscriminatory terms to all in the trade *or if its charges were not reasonable*. Therefore, in order to foster efficient market development and operation and to provide a first line of defense against anti-competitive practices, Sections 11A(b) and (c)(1) would grant the SEC broad powers over any exclusive processor and impose on that agency a responsibility to assure the processor's neutrality and the reasonableness of its charges in practice as well as in concept.⁵⁵

The Commission used its national market system authority to adopt two important rules relating to market data. The Quote Rule, former Rule 11Ac1-1 (now Regulation NMS Rule 601), requires all broker-dealers to report all of their securities transactions and best bids, offers and quotation sizes to the relevant exchange. Broker-dealers must report this information immediately, and for free. The Display Rule, former Rule 11Ac1-2 (now Regulation NMS Rule 602), then requires broker-dealers to purchase that same information back from the relevant exclusive SIP: broker-dealers are required to display to their customers the last sale and best-bid-and-offer quotation data for securities. Because there is only one SIP for each relevant market (one for exchange-traded securities, one for Nasdaq and OTC securities, and one for options), broker-dealers must buy their Display Rule market data back from those SIPs in order to provide it to customers. The price that the market data utilities can extract for this regulatory-required data is limited only by the SEC's review process for market data fees.⁵⁶

The three exclusive SIPs allocate market data fee revenues among the member exchanges pursuant to their market data plans. The only significant change in the Commission's regulation of market data in the past twenty-five years has been in Regulation NMS. Formerly, market data revenues were allocated based on the number of trades executed in each participating market. The Commission feared that this methodology encouraged “tape shredding,” or splitting up large trades into multiple smaller trades for the

⁵⁵ *Securities Acts Amendments of 1975*, Report of the Senate Comm. on Banking, Housing and Urban Affairs to Accompany S.249, S. Rep. No. 94-75, 94th Cong., 1st Sess. 11-12 (1975).

⁵⁶ The Commission reviews market data rule filings, like other SRO rule changes, pursuant to Section 19(b) of the Exchange Act. Rule filings that only change the level of fees are immediately effective upon filing under Rule 19b-4(f)(2), although the Commission may abrogate those filings after providing an opportunity for notice and comment.

purpose of obtaining market data revenue.⁵⁷ Therefore, the Commission imposed a new formula which allocates market data revenue in part based on executions, and in part based on quality of quotations (as measured by the percentage of time that a given market is quoting the best prices for a security).⁵⁸ At the same time, the Commission also directed the exchanges to establish non-voting market data advisory committees, but gave those committees no authority to affect the exchanges' pricing decisions.

⁵⁷ Beginning in the past decade, several markets began market data rebate programs, in which they shared the market data revenues they received with broker-dealers who executed trades in those markets, as an incentive for those broker-dealers to route trades to those markets. See Report of Investigation Regarding the Nasdaq Stock Market, Inc. (Nasdaq), as Overseen By Its Parent the National Association of Securities Dealers, Inc. (NASD), Exchange Act Release No. 51,153 (Feb. 9, 2005) (finding that Nasdaq and NASD failed adequately to investigate potential wash sales and matched orders by a market participant, in part because those orders increased the amount of market data revenues earned by Nasdaq).

⁵⁸ Regulation NMS Adopting Release, Exchange Act Release No. 51,808 (June 9, 2005).