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Via email to rule-comments@sec.gov

Florence Harmon
Acting Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

**Re: Proposed Order Regarding NYSE Arca “Market Data” Product
Release No. 34-57917, File No. SR-NYSEArca-2006-021**

Dear Ms. Harmon:

On July 10, 2008, the Securities Industry and Financial Markets Association (“SIFMA”) submitted “An Economic Study of Securities Market Data Pricing by the Exchanges” (the “Economic Study”) criticizing the June 4, 2008, Proposed Order Approving Proposal by NYSE Arca, Inc. (“Proposed Order.”). The Economic Study is profoundly flawed and deserves little or no weight in the Commission’s consideration of whether to adopt the Proposed Order.

- 1. SIFMA’s analysis of competition for order flow is flawed because it relies on data that improperly combines the market share of exchanges with the market share of Trade Reporting Facilities (“TRFs”).***

The SEC properly concluded that competition for order flow and executions provides pricing discipline for market data products. In contrast, SIFMA’s analysis of competition exaggerates Nasdaq’s share of executions and obscures a key element of competition from electronic communications networks (“ECNs”) and broker-dealers.¹ SIFMA accomplishes this distortion by combining executions on the NASDAQ exchange with internalized executions reported to the FINRA/NASDAQ TRF. Tables 1, 3, 4 and 5 clearly demonstrate that SIFMA’s analysis of NASDAQ-listed stocks is based upon

¹ The Economic Study also combines NYSE LLC exchange data and NYSE Arca exchange data, as well as their respective TRFs. Without commenting on SIFMA’s claims about the merits of combining NYSE LLC and NYSE Arca data, combining exchange and TRF data is clearly incorrect.

combined data for each exchange and its FINRA-sponsored TRF.² By combining exchange and TRF data, SIFMA obscures a substantial amount of competition for order flow that it purports to measure, competition provided by ECNs and broker-dealers that execute trades away from and in competition with the exchanges.

This flaw undercuts all of SIFMA's conclusions regarding competition for order flow. For example, tables 3, 4, and 5 purportedly measure the concentration of executions at **exchanges** when, in fact, they measure nothing of the sort. SIFMA artificially inflates the market share and HHI statistics for NASDAQ-listed stocks by incorrectly combining reported volume of the FINRA TRF with that of the NASDAQ exchange. SIFMA then uses the inflated numbers to claim that NASDAQ dominates trading.

Table 4 is particularly revealing. It purports to show that NASDAQ is approaching perfect monopoly power for block trading in its most active stocks. In reality, publicly available data demonstrates that nearly **all** block trading in those stocks is executed away from and in competition with NASDAQ and then reported to a TRF. The Economic Study does not disclose that the SRO with far and away the largest block market share is FINRA, not NASDAQ or the NYSE Group. Because TRF block volume reflects trades reported to FINRA by numerous trading venues, the correct conclusion from a proper and complete examination of the data is that block volume is highly competitive. Instead, the Economic Study falsely claims that block trading is more concentrated than non-block trading. Had the Economic Study taken care to calculate HHI statistics from the data supplied in Table 6 it would have seen that the values of 4,100 to 9,300 reported in Tables 3, 4, and 5 for NASDAQ-listed stocks were wrong.

2. *SIFMA's analysis of competition for order flow is flawed because it ignores the contestability of the market for order flow and executions which the Department of Justice deemed critical to a meaningful competition analysis.*

In addition to citing flawed concentration statistics, SIFMA also fails to account for competitive factors that can overcome a high concentration figure, such as ease of new entry. According to the Department of Justice ("DOJ") Horizontal Merger Guidelines cited by the Economic Study, concentration is just one factor that is relevant to competitive analysis: "market share and concentration data provide only the starting point for analyzing the competitive impact of a merger. Before determining whether to challenge a merger, the Agency also will assess the other market factors that pertain to competitive effects, as well as entry, efficiencies and failure."³ SIFMA's selective use of the Horizontal Merger Guidelines casts further doubt on its competition analysis.

² SIFMA's statistics for NYSE-listed stocks repeat this error by combining data for the NYSE, NYSE Arca, and their TRFs.

³ *US Department of Justice and Federal Trade Commission Horizontal Merger Guidelines*, Section 2.0. See also, Economic Study at fn. 12 and accompanying text.

In fact, DOJ found that ease of entry of new competitors was a critical factor to the approval of mergers between Nasdaq and INET and the New York Stock Exchange and Archipelago Holdings:

... the Department was able to focus its investigations of these significant transactions on the critical and determinative issue of entry. Specifically, the Department examined whether the planned and likely entry of several firms, including regional stock exchanges supported by investments from some of the nation's largest securities firms and investment banks, will be sufficient to resolve any competitive concerns raised by the transactions. The Department has determined that the imminent entry of these enterprises should result in additional, viable alternatives to the two merged firms sufficient to ensure that the markets remain competitive.⁴

Ease of entry has been confirmed after those mergers by the approval of BATS Trading to operate as a registered national securities exchange, by the partnership between DirectEdge ECN and the International Securities Exchange ("ISE"), and by the rapid emergence and penetration of numerous "dark pools" of liquidity. The record in this matter is replete with examples of entrants that swiftly grew into some of the largest electronic trading platforms and proprietary data producers: Archipelago, Bloomberg Tradebook, Instinet, Island, RediBook, Attain, TracECN, BATS Trading and DirectEdge.

The Economic Study also claims that NASDAQ and NYSE Group have used network externalities and acquisitions to maintain dominant positions in NASDAQ-listed and NYSE-listed securities, respectively. This claim is not supported by the data. The last acquisition of a major U.S. cash equity trading platform by NASDAQ or the NYSE was completed in the first quarter of 2006. Over the two subsequent years from July 2006 to July 2008 NASDAQ's market share in NASDAQ-listed stocks fell from 48.8% to 41.9%. Similarly, the NYSE LLC's market share fell from 66.6% to 26.9% and the NYSE Group's market share has fallen from 72.6% to 43.4%. There is robust and successful competition in the market for cash equity order flow and executions.

3. *SIFMA's analysis of competition is flawed because it misunderstands in several ways the concept of substitution.*

Section II.B. of the Economic Study incorrectly analyzes supply-side substitution. The idea behind supply-side substitution concerns the ability of alternative producers to react to a price increase by increasing supply to satisfy the demand of consumers facing a price increase. If other producers can respond to an increase in price of a product from a single producer by switching production or entering the market for that product, then the increase in supply may render any contemplated price increase unprofitable. Therefore, supply-side substitution limits market power.

⁴ *Department Of Justice Antitrust Division Statement On The Closing Of Its Two Stock Exchange Investigations*, November 16, 2005, available at www.usdoj.gov/atr/public/press_releases/2005/213062.htm.

The orders held by markets are not organic to the markets but are acquired by the exchanges from the members as the markets compete for order flow through fees, rebates, and offered services. If a market increases data fees without an offsetting increase in value offered to providers of that data, the market's business will be undercut, rendering the data fee increase unprofitable.

Consider the three criteria cited in the study. The first criterion requires current producers of the product to be able to increase output from existing facilities. The business of operating a market is typified by low marginal cost for additional volume and markets operating with significant excess capacity. The existing competitors could readily absorb more market volume and market share on their current facilities and thereby produce more market data. The second criterion requires establishing the potential for new entry and this has been shown to be the case in Point 2 above. The third requires that new competitors be able to enter the market. As described above, this is amply demonstrated by ISE and CBOE becoming cash equities exchanges and by BATS ECN entering the market and being approved to operate a registered exchange.

4. *SIFMA's analysis of competition is flawed because it overstates the liquidity externalities currently available to securities exchanges.*

One outcome of the pro-competitive actions by the Commission in cash equities (most prominently Unlisted Trading Privileges, the Order Handling Rules, and Regulation NMS) has been a weakening of the so-called "liquidity externality." To the extent that it exists, a liquidity (or network) externality creates forces tending towards the maintenance of a single, dominant market for a given security. Indeed, such an effect may have been present in the past, leading towards the historical position of traditional listing markets. As indicated above, however, whatever level of externality might have prevailed in the past has now vanished, as market share is highly mobile and market entry routine. Market participants using advanced technology have responded to SEC rule-making by creating a network of interlinked, competing markets and venues that make up the national market system. The evidence of declining and shifting market share shows that traditional listing exchanges no longer possess a network externality to maintain their positions.

5. *SIFMA's analysis of demand for market data is flawed because it misconstrues the characteristics of the national best bid and offer ("NBBO") and its role in the market for executions.*

It is misleading to cite the NBBO as a measure of trading interest available to investors because the NBBO is missing substantial liquidity that is widely available. First, the NBBO shows just the single market setting the inside quote, not all markets quoting at the NBBO. In today's competitive environment, however, multiple markets quote at the inside and Regulation NMS requires that investors' orders access all those quotes. Second, SIFMA's analysis overlooks liquidity that is un-displayed but widely available in exchange markets, dark pools, ECNs and broker-dealers' trading desks. Most market participants, including Nasdaq, use sophisticated order routers that sweep both hidden and displayed liquidity on all exchange markets quoting at the NBBO, and

many, such as LAVA, also probe liquidity that is hidden in dark pools and at specific broker-dealers. Finally, data collected pursuant to Exchange Act Rules 605 and 606 shows that market orders received by broker-dealers generally are not routed to an exchange market at all; they are executed internally against liquidity that is un-displayed in any market. In fact, Rule 606 data from the second quarter of 2008 shows that a sample of major broker-dealers routed just 15% of retail orders in NASDAQ-listed stocks to an exchange. A proper analysis would reflect the requirements of Regulation NMS and would rely upon aggregate displayed liquidity at the NBBO plus hidden liquidity, not just the liquidity in the NBBO message from the network processors.

6. *SIFMA's analysis of demand for market data is flawed because it mistakes the exchanges' enthusiasm for the value of their products with a legal obligation to purchase them.*

Despite the exchanges' best efforts to market depth-of-book data to the securities industry, the un-refuted empirical evidence shows that just five percent of professional users of market data purchase depth-of-book data. In other words, 95 percent of the securities industry has rejected SIFMA's argument.⁵ The inability of exchanges to market depth-of-book data more broadly is attributable largely to the fact that there is no regulatory requirement to purchase depth-of-book data.

This issue – like others – was thoroughly debated by commentators and is analyzed and addressed in detail in the Commission's Notice (page 5) and Draft Approval Order (pages 17, 18, 67, and 68). The regulatory and competitive importance of depth-of-book data is raised in several of SIFMA's eight comment letters, in two of the NetCoalition's four comment letters, and in Schwab's comment letter. After analyzing each argument in each comment letter, the Commission concluded, at pages 5 of the Notice and 67 of the Draft Approval Order, that "broker-dealers are not required to obtain depth-of-book order data, including the NYSE Arca data, to meet their duty of best execution." The Commission took the unusual step of asking commentators (at page 5 of the Notice) how the Commission could make that point clearer. NASDAQ submits that it cannot be said more clearly.

7. *SIFMA's analysis of demand for market data is flawed because it inaccurately describes the availability of liquidity away from the inside within the national market system.*

One potential reason broker-dealers refuse to purchase depth-of-book data is the level of completeness of depth data. It is a regulatory requirement for broker-dealers to transmit to exchanges their best-priced orders but there is no requirement to transmit orders at inferior prices. As a result, depth-of-book feeds contain best-priced orders that are at the inside or away from the inside as well as inferior priced orders that broker-

⁵ As the Commission explained at page 58, "The fact that 95% of the professional users of core data choose not to purchase the depth-of-book order data of a major exchange strongly suggests that no exchange has monopoly pricing power for its depth-of-book order data."

dealers voluntarily provide to exchanges. Thus, depth-of-book feeds suffer from the same problem of hidden liquidity that affects the display of liquidity at the NBBO but that problem is magnified by the selective and strategic disclosure of depth by certain broker-dealers. When choosing to purchase a depth feed or not, a market data consumer must consider what percentage of depth liquidity it will see and what is motivating certain broker-dealers to reveal it.

8. *SIFMA's analysis of market data pricing is flawed because it ignores the total cost of market data consumption and focuses instead on the small component of total cost attributable to exchanges.*

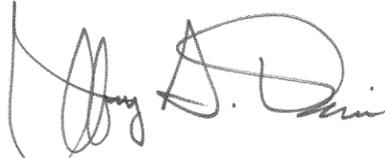
SIFMA's analysis of market data costs focuses exclusively on exchange data which is a relatively small component of the total cost of market data consumption. In addition to the cost of exchange data, total market data cost includes network bandwidth, data feed handlers, ongoing technical support, and administration expenses. These costs exceed the cost of exchange data, often by magnitudes depending on the amount of data consumed and the infrastructure of the firm consuming it. Moreover, by consolidating INET and NASDAQ data and eliminating a unique data feed, NASDAQ actually reduced the total cost of market data for many consumers by eliminating line handler, technical support and administration expenses associated with the discontinued data feed. SIFMA, by ignoring the total cost of consuming market data and the efficiency gained by consolidating two data feeds into one, overstates the impact of the NASDAQ-INET merger on market data purchasers.

9. *SIFMA's market power analysis is flawed because it understates the ability of broker-dealers and other non-exchanges to produce competing market data products.*

SIFMA's "market power" argument rests on a premise that is transparently false: that the exchanges have market power with respect to their own sole source data. The Commission thoroughly documents that there are numerous SROs, ECNs, TRFs, and BDs competing fiercely for the inputs of market data and each is capable of producing proprietary depth-of-book data products. Any ECN or BD can combine with any other ECN, broker-dealer, or multiple ECNs or BDs to produce jointly proprietary data products. Additionally, non-broker-dealers such as order routers and dark pools like LAVA and LiquidNet can facilitate single or multiple broker-dealers' production of proprietary data products. Multiple market data vendors already have the capability to aggregate data and disseminate it on a profitable scale, including Bloomberg, Reuters and Thomson. "Project BOAT," a consortium of financial institutions that operates a cooperative trade collection facility, would expand from Europe to the U.S. if U.S. market data was sufficiently costly to make a U.S. venture profitable.

NASDAQ appreciates the opportunity to assist the Commission in its assessment of the Proposed Order. We encourage the Commission to carefully evaluate and address all comments submitted in this matter, and then to act promptly to resolve this two-year review process by approving the Proposed Order.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Jeffrey S. Davis". The signature is fluid and cursive, with the first name being the most prominent.

Jeffrey S. Davis
Vice President and
Deputy General Counsel

cc: Chairman Christopher Cox
Commissioner Luis A. Aguilar
Commissioner Kathleen L. Casey
Commissioner Troy A. Paredes
Commissioner Elisse B. Walter
Erik Sirri, Director, Division of Trading and Markets
Robert L.D. Colby, Deputy Director, Division of Trading and Markets
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