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VIA ELECTRONIC DELIVERY

Mr. Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Petition for Rulemaking Concerning Market Data Fees (File No. 4-716)

Dear Mr. Fields:

The Nasdaq Stock Market LLC (“Nasdaq”) respectfully urges the Commission to decline to initiate the rulemaking proceedings concerning market-data fees requested by the petition filed on December 6, 2017 by several large financial institutions and trading firms and a leading market information firm (“petitioners”).¹ The petitioners’ proposal to require exchanges to disclose their market-data costs and revenue would impose unnecessary burdens on exchanges by opening the door to the type of inefficient cost-based ratemaking that the Commission and courts have resoundingly rejected. Nor would a rule mandating the disclosure of this cost and revenue information do anything to enhance the robust competitive forces that already meaningfully constrain exchanges’ market-data pricing. If anything, the petitioners’ proposal would stifle competition and innovation in the market-data sector—to the substantial detriment of the investing public—by needlessly increasing regulatory compliance costs. This is precisely the type of “unnecessary regulatory burden[]” that the Administration has sought to eliminate. Exec. Order No. 13777, 82 Fed. Reg. 12,285, 12,285 (Mar. 1, 2017). The Commission should decline the petitioners’ request.

Advances in market-data availability and analytics have enabled broker-dealers to offer the best execution and most liquidity at the lowest cost to investors—helping to fuel competition

¹ Letter submitted by Ben Brown, Patomak Global Partners, to Brent J. Fields, Secretary, Commission (Dec. 6, 2017) (File No. 4-716) (*available at* <https://www.sec.gov/rules/petitions/2017/petn4-716.pdf>) (“Pet.”).

between traditional Wall Street firms and new entrants, and making the U.S. capital markets the largest and strongest in the world. The competitive market for proprietary data products has flourished. The sector is characterized by low barriers to entry, and competition from new entrants has enhanced the already vigorous competition that existed among Nasdaq and other exchanges to attract market-data customers. Investment in smarter, deeper, faster data has driven innovation in financial services and helped bring down the cost of stock trading, mutual funds, and ETFs to a fraction of what they were even 10 years ago.

To differentiate itself in that competitive market, Nasdaq has invested millions of dollars in improvements to its market-data products, frequently without implementing corresponding price increases, which has enhanced the quality and selection of market-data products available to the investing public. Because an exchange's trading services are a necessary prerequisite to its data business—an exchange would have no data to sell without executing transactions—the production of market data requires exchanges to incur high fixed, joint, and common costs.

Most investors do not need access to complex analytical products, such as depth-of-book data, and certainly do not need to purchase such products from all exchanges. Nevertheless, a range of real-time information products is widely and inexpensively available to retail investors (including Nasdaq depth-of-book data for \$15 per month or less). To the extent that a small percentage of highly sophisticated traders may require depth-of-book data from all exchanges, the prices they pay are restricted by competition among the exchanges to attract order flow. The petitioners' request is a transparent effort to use the regulatory process to enhance their own financial position by overriding those competitive forces. The Commission should reject the petitioners' self-interested rulemaking request.

I. Background

For more than a decade, the nation's largest financial institutions and trading firms have advocated for government limits on prices that Nasdaq and other exchanges charge for their proprietary market-data products. Under the auspices of the Securities Industry and Financial Markets Association ("SIFMA")—an industry group of which many of the petitioners in this matter are members—these banks and institutional investors urged the Commission to adopt a cost-based approach to evaluating whether exchanges' market-data fees are consistent with the Securities Exchange Act ("Exchange Act"). The Commission rejected SIFMA's preferred cost-based approach in favor of a market-based standard that looks to "whether the exchange was subject to significant competitive forces in setting the terms of its proposal." *Order Setting Aside Action by Delegated Authority and Approving Proposed Rule Change Relating to NYSE Arca Data*, 73 Fed. Reg. 74,770, 74,781 (Dec. 9, 2008). The Commission concluded that the cost-based alternative was marred by "a whole host of difficulties in calculating the direct costs and common costs of market data." *Id.* at 74,794.

The D.C. Circuit thereafter upheld the Commission's market-based approach. *See NetCoalition v. SEC*, 615 F.3d 525 (D.C. Cir. 2010). Rejecting SIFMA's argument that the

Exchange Act requires the Commission to treat exchanges “as public utilities,” the court emphasized that Congress intended the national market system to evolve through competitive forces—without unnecessary regulatory restraints—and held that the Commission’s market-based approach is consistent with its “statutorily-granted flexibility in evaluating market data fees.” *Id.* at 534-35.

In the wake of those decisions, the competitive market for proprietary data products has flourished. The sector is characterized by low barriers to entry, and competition from new entrants has enhanced the already vigorous competition that existed among Nasdaq and other exchanges to attract market-data customers. To differentiate itself in that competitive market, Nasdaq has invested millions of dollars in improvements to its market-data products, often without implementing corresponding price increases, which has enhanced the quality and selection of market-data products available to the investing public.

Despite this competitive market and the D.C. Circuit’s decision endorsing the Commission’s regulatory approach, SIFMA has persisted in its attempt to constrain via legal action exchanges’ market-data pricing. After Congress amended the Exchange Act to provide that exchanges can designate rules setting market-data fees as immediately effective upon filing, 15 U.S.C. §78s(b)(3)(A), SIFMA sought to challenge the Commission’s nonsuspension of an immediately effective market-data fee filing as arbitrary and capricious, but the D.C. Circuit held that it lacked jurisdiction to entertain that challenge. *See NetCoalition v. SEC*, 715 F.3d 342, 354 (D.C. Cir. 2013).

In response, SIFMA resorted to the denial-of-access procedure under Sections 19(d) and 19(f) of the Exchange Act to challenge the exchanges’ market-data fees. Since 2013, SIFMA has filed scores of denial-of-access applications challenging *more than 200* market-data fee filings by Nasdaq and other exchanges. SIFMA alleges in each of those proceedings that the fees in question are so high as to constitute an unlawful limitation on access. SIFMA reflexively challenges virtually every new market-data fee filing by Nasdaq and other exchanges, without regard to the substance of each particular filing or the massive administrative burden that resolving these scores of denial-of-access applications would impose on the Commission.

The Commission assigned the lead denial-of-access proceeding—which pertains to certain fees that Nasdaq and NYSE Arca, Inc. charge for their depth-of-book data products—to the Chief ALJ for a hearing. The Chief ALJ held a week-long trial on the merits, in which the parties presented expert testimony and fact witness testimony, introduced an extensive set of documents into the record, and submitted pre-trial and post-trial briefing. Based on that extensive record, the Chief ALJ issued a 44-page decision on the merits, which included extensive and detailed findings of fact.

After receiving testimony from multiple witnesses during a five-day hearing, the Chief ALJ issued a detailed opinion rejecting SIFMA’s challenge because the exchanges are “subject to significant competitive forces in setting fees for depth-of-book data,” including “the availability of alternatives to the Exchanges’ depth-of-book products, and the Exchanges’ need to attract order flow from market participants.” *In the Matter of the Application of Sec. Indus. &*

Fin. Markets Ass'n for Review of Actions Taken by Self-Regulatory Organizations, File No. 3-15350, at 31 (June 1, 2016) (“Op.”). Applying the market-based approach adopted by the Commission and upheld by the D.C. Circuit, the Chief ALJ explained that “[c]ost and profit margin data are not required” to assess whether competitive forces constrain market-data fees. *Id.* at 33.²

Despite the Commission’s rejection of cost-based ratemaking, the petitioners now ask the Commission to initiate a rulemaking that would require, among other things, that exchanges “disclose all revenues and costs, itemized by product and service, associated with their collection and dissemination of market data.” Pet. 7.

II.

The Proposed Disclosures Are Unnecessary.

We respectfully ask the Commission to reject this latest effort to subject Nasdaq and other exchanges to unwarranted regulatory burdens. The petitioners’ request for a rule requiring exchanges to disclose their market-data costs and revenues is at odds with the Administration’s deregulatory priorities and the decisions of the Commission and the D.C. Circuit rejecting a cost-based approach to evaluating market-data fees in favor of a market-based standard. Because the validity of market-data fees turns on whether the exchanges are subject to competitive forces in setting those fees—not on an artificial examination of the exchanges’ costs and revenues—the petitioners’ request would not shed any light on the validity of exchanges’ market-data fees. Indeed, the extensive record compiled in the proceeding before the Chief ALJ—as well as the Chief ALJ’s detailed factual findings—make clear that exchanges are subject to substantial competitive pressures that constrain them from setting their market-data fees at supracompetitive levels. The cost and revenue data requested by the petitioners would not add anything to that analysis but instead would merely burden exchanges with unnecessary regulatory requirements and compliance costs.

A. The Petition Seeks The Imposition Of A Cost-Based Ratemaking Approach That Has Been Condemned By The Commission And Courts.

The disclosures of cost and revenue data proposed in the petition would represent a dramatic departure from the Commission’s market-based standard for evaluating proprietary data fees and an unwarranted step in the direction of a cost-based ratemaking approach that has been widely rejected by agencies and courts. Mandating the disclosures proposed in the petition would require the Commission to provide a reasoned basis for breaking with this consensus and

² The Commission thereafter granted SIFMA’s petition for review. On November 30, 2017, the Commission issued an order remanding the matter to the Chief ALJ, *see* Order, In re Pending Administrative Proceedings, Securities Act Release No. 10,440, at 1 (Nov. 30, 2017), who subsequently ratified her prior opinion rejecting SIFMA’s challenge, *see* Order Ratifying Prior Action, File No. 3-15350 (Dec. 21, 2017). SIFMA filed a “protective” petition for review of the Chief ALJ’s decision on remand on January 31, 2018.

for disregarding the record and findings in the SIFMA denial-of-access proceeding, which the petition manifestly fails to do.

When Congress passed the 1975 amendments to the Exchange Act, its “objective” was “to enhance competition and to allow economic forces, interacting within a fair regulatory field, to arrive at appropriate variations in practices and services.” S. Rep. No. 94-75, at 8 (1975). Congress charged the Commission with developing a system that would “evolve through the interplay of competitive forces as unnecessary regulatory restrictions are removed.” H.R. Conf. Rep. No. 94-229, at 92 (1975).

In 2008, the Commission reaffirmed that “Congress intended to rely on competitive forces to the greatest extent possible” and explained that, “[i]f competitive forces are operative, the self-interest of the exchanges themselves will work powerfully to constrain unreasonable or unfair behavior.” 73 Fed. Reg. at 74,780–81. Applying those principles to market-data fees, the Commission concluded that “reliance on competitive forces is the most appropriate and effective means to assess whether terms for the distribution of non-core data are equitable, fair, and reasonable, and not unreasonably discriminatory.” *Id.* In adopting that market-based approach, the Commission built upon the settled consensus among agencies and courts that cost-based ratemaking is antiquated, inefficient, and unnecessary. *See, e.g., Nat’l Rural Telecomm. Ass’n v. FCC*, 988 F.2d 174, 178 (D.C. Cir. 1993) (explaining that cost-based regulation “is costly to administer, as it requires the agency endlessly to calculate and allocate the firm’s costs”).

A cost-based regulatory approach is particularly ill-suited to evaluating proprietary market-data fees. As the Chief ALJ recognized, even if an examination of costs may be appropriate in some markets, cost and revenue information for market-data products is “misleading” and “of limited value.” Op. 32. Because an exchange’s trading services are a necessary prerequisite to its data business—an exchange would have no data to sell without executing transactions—Nasdaq and other exchanges have high fixed, joint, and common costs associated with their market data. Those joint costs make it impossible to draw conclusions based on the marginal cost of a market-data product. *See, e.g., Morgan v. Ponder*, 892 F.2d 1355, 1362 n.17 (8th Cir. 1989); *Kaiser Found. v. Abbott Labs.*, No. CV 02-2443-JFW, 2009 WL 3877513, at *9 (C.D. Cal. Oct. 8, 2009); *cf. United States v. Eastman Kodak Co.*, 63 F.3d 95, 109 (2d Cir. 1995) (“Certain deviations between marginal cost and price, such as those resulting from high fixed costs, are not evidence of market power.”). Exchanges’ true costs of providing their proprietary market-data products thus can only be determined by taking into account the costs of operating their entire trading platform, including regulatory costs.

Even though those trading-platform costs are necessary for Nasdaq to sell exchange proprietary market data, Nasdaq does not allocate *any* of those costs to market data in its internal accounting methodologies because Nasdaq has maintained consistent reporting of its costs dating back to the period before it had a proprietary data business. In other words, Nasdaq’s longstanding cost-allocation approach is sound for accounting and business-management purposes, but it yields accounting data that are meaningless for evaluating the propriety of Nasdaq’s data pricing.

Accordingly, the petitioners' request that the Commission compel exchanges to disclose their cost and revenue information for market-data products would lead the Commission down a path toward an inherently arbitrary cost-based regulatory approach that has been rejected by Congress, the Commission, and the courts. And it would yield data that do not provide any insights into whether the price for a particular market-data product has been set at a supracompetitive level.

B. Competition Among Market-Data Products And Competition For Order Flow Significantly Constrain Market-Data Prices.

In addition to suffering from fatal legal and practical deficiencies, the petitioners' proposal is also unnecessary because competitive forces substantially constrain exchanges' ability to raise market-data prices to unlawful levels.

One of those competitive constraints is imposed by the intense competition among exchanges to attract market-data customers. As the Chief ALJ found in the SIFMA denial-of-access proceeding, depth-of-book data products "function as substitutes for each other" for the vast majority of market participants because, "when weighted by trading volume, the likelihood that a security trading on one major exchange trades on another major exchange is over 99%." Op. 33. This "overlap in traded stocks" makes depth-of-book products from one exchange substitutable for all but a small percentage of highly sophisticated traders that may require market data from all exchanges to pursue some of their computerized trading strategies. *Id.*

The substitutability of market-data products is confirmed by the relatively modest number of traders who actually purchase these products. Far from having "no choice but to purchase" market data, Pet. 1, "most customers do not require any sort of depth-of-book data," Op. 36. Even among those customers who do subscribe to some data products, most do not need every product. The Chief ALJ found that "fewer than 10% of Nasdaq's market data customers subscribe to Nasdaq's comprehensive depth-of-book product." *Id.* These low usage levels are consistent with the Commission's statement that it "does not believe that broker-dealers are required to purchase depth-of-book order data . . . to meet their duty of best execution." 73 Fed. Reg. at 74,779.

Because most traders do not need depth-of-book and other proprietary market data from every exchange—and many do not need any proprietary market data at all—traders can switch data products, reduce their use of particular products, or stop making market-data purchases altogether in response to exchanges' price increases. Indeed, switching among products is "commonplace," as evidenced by the "numerous firms" and "large percentage of customers" that switch products each year. Op. 33–34. These economic forces substantially constrain the ability of exchanges to raise the price of their market-data products.

Even for the small number of highly sophisticated traders that may need multiple depth-of-book products, the prices of market data are still restricted by competition among the exchanges to attract order flow. It is beyond dispute that competition for order flow—"the core

competitive concern of any equity exchange,” 73 Fed. Reg. at 74,782—is fierce. After all, in the absence of orders, exchanges would not have any market data to sell.

As the Chief ALJ found, the small fraction of firms that may require multiple depth-of-book products for their computer-based trading models have “strong leverage in negotiations” through their control of order flow. Op. 37. They account for as many as 90% of trades on Nasdaq’s platform, and large customers can shift their flow quickly and easily. *Id.*

This leverage is illustrated by an example, discussed at length by the Chief ALJ, in which a firm shifted order flow in response to a market-data price increase. An employee of the firm warned that, because Nasdaq’s valuation depends on “clients (brokers, market makers, etc.) . . . placing orders with NASDAQ,” its valuation would “dissipate quickly as we begin pulling orders away from NASDAQ.” Op. 37. The firm then did just that, reducing its trading volume on Nasdaq by about 50%. *Id.* at 38.

Even the threat of a shift in order flow can constrain prices for market data. In fact, as Chief ALJ’s decision reflects, one of the petitioners seeking a rulemaking threatened to decrease its trading volume and “forced Nasdaq to institute a cap on fees in order to preserve their business.” Op. 38. This was not an isolated incident, either; other firms have made similar threats. *Id.* And it was “obvious” to the Chief ALJ “that the Exchanges take these threats seriously.” *Id.* at 40. Thus, like competition for market-data customers, shifts in order flow and the mere threat of a shift impose a significant constraint on exchanges’ pricing of market-data products.

The impact of these competitive constraints is reflected in the fact that prices for market data are relatively constant. The Chief ALJ found that “the Exchanges have largely not raised their depth-of-book prices since each initially imposing fees.” Op. 35. In fact, adjusted for inflation, the real price of many market-data products has *decreased* over time—despite significant enhancements and improvements to the products over the years. These prices underscore that Nasdaq and other exchanges carefully balance price against projected customer substitution and the potential impact on order flow when they make market-data pricing decisions.

The competition among providers of market data also makes cost and revenue data highly competitively sensitive. The D.C. Circuit has rejected disclosures of certain cost data in other settings under the trade-secrets exemption to the Freedom of Information Act. *See McDonnell Douglas Corp. v. U.S. Dep’t of the Air Force*, 375 F.3d 1182, 1191, 1192 (D.C. Cir. 2004). Disclosure of cost and revenue information about market data would produce similar competitive harm here.

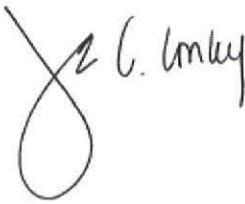
In sum, the ability of Nasdaq and other exchanges “to price their depth-of-book products is constantly under pressure from their biggest customers, and those customers’ ability to control order flow.” Op. 42. This enormous leverage, together with the substitutability of data for almost all traders, drastically constrains exchanges’ ability to increase their market-data prices. In light of this vigorous competition, it would be pointless for the Commission to require

disclosure of information about costs and revenue. Indeed, the petitioners' request is a transparent effort by a group of highly profitable, sophisticated entities to co-opt the regulatory process for their own financial gain.³

* * *

The Commission should reject this latest attack on the exchanges' market-data pricing. The prices that exchanges charge for their market-data products are meaningfully constrained by competition among data products and competition to attract order flow. Applying antiquated principles of cost-based ratemaking to this competitive market would be unnecessary, inefficient, and unduly burdensome.

Respectfully,

A handwritten signature in black ink, appearing to read "G. Linsky". The signature is stylized, with a large loop at the bottom and a flourish extending upwards and to the left.

³ The Treasury Report cited by the petitioners (at 5 n.20) does not call into question the competitive constraints on market-data pricing. See U.S. Dep't of Treasury, *A Financial System That Creates Economic Opportunities* 63-64 (Oct. 6, 2017), available at <https://www.treasury.gov/press-center/press-releases/Documents/A-Financial-System-Capital-Markets-FINAL-FINAL.pdf>. The report's cursory two-page analysis does not grapple with any of the extensive evidence of competition identified by the Chief ALJ and is at odds with the conclusion of the Department of Justice's Antitrust Division, which has determined on multiple occasions that exchanges compete with each other in the sale of market-data products. See U.S. Dep't of Justice, *NASDAQ OMX Group Inc. and IntercontinentalExchange Inc. Abandon Their Proposed Acquisition of NYSE Euronext After Justice Department Threatens Lawsuit* (May 16, 2011), available at <https://www.justice.gov/opa/pr/nasdaq-omx-group-inc-and-intercontinentalexchange-inc-abandon-their-proposed-acquisition-nyse>; U.S. Dep't of Justice, *Department of Justice Antitrust Division Statement of the Closing of its Two Stock Exchange Investigations* (Nov. 16, 2005), available at https://www.justice.gov/archive/atr/public/press_releases/2005/213062.htm.