

# Charles Schwab

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MEMORANDUM

March 20, 2001

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**TO:** Joel Seligman, Chairman SEC Advisory Committee on Market Information  
Annette Nazareth, Director SEC Division of Market Regulation  
Members, SEC Advisory Committee on Market Information

**FROM:** Carrie Dwyer  
Executive Vice President, Corporate Oversight  
Charles Schwab & Co., Inc.

**RE:** **March 1 Meeting Follow-up: Unanswered Questions Relating to Market Data Pricing**

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As I had indicated at the last meeting of the Advisory Committee on Market Information on March 1, 2001, we believe certain questions relating to the pricing of market information must be addressed in order for the committee to make meaningful progress. We believe that answering these questions will provide the committee with the much-needed fact finding that will help us to fully understand how market-information pricing is determined and administered. The answers to these questions are extremely relevant to the committee's decisions about how to fix, modify or replace the current system. Without this information, we cannot fully evaluate current practices or determine what changes to the system are advisable. In particular, our questions are:

- How exactly is market information priced and what are the full extent of the costs and burdens imposed on broker-dealers and market data vendors taking into account all exhibits and pilot programs?

For example, the NYSE and the NASD post the basic pricing terms on their web sites for Network A and Nasdaq information, respectively. However, additional terms and conditions are imposed through mandatory exhibits to the primary contracts. These conditions appear to be imposed on a case-by-case basis by the plan administrator in negotiations with the broker-dealer or data vendor. The additional conditions may result in costs and burdens that vary from participant to participant. Without an understanding of the full scope of the costs and practices relating to contract exhibits and pilot programs, we cannot meaningfully address the costs borne by market participants in receiving and redistributing market information. Nor can we understand or evaluate the full amount of revenues earned by the exchanges and the NASD for the distribution of this information.

- What do the different classes of market participants (or others) pay for market information? How are these differences in fees determined? How are fees allocated among different participants? Do all similarly situated participants pay the same rates?

We believe it is critical to know the bases used by the exchanges and Nasdaq in setting fees for different classes of market participants. For example, if criteria exist that distinguish market participants on some articulated basis, this could be

very significant. Equally significant would be the case where market participants are treated differently for no specific reason. If we cannot determine how different market participants pay differing fees, we will not be able to fully appreciate the current market-information structure that we are endeavoring to repair.

Obtaining this information will enable the Committee to meaningfully compare the different fees paid by market data vendors, broker-dealers (online and traditional), media outlets, institutional firms and others and to determine whether these fees are equitably allocated. In particular, it will shed light on the degree to which different classes of market-information users may pay differing fees, and whether similarly situated users pay differing fees.

- How are the specific arrangements negotiated, and what is the relationship to various exchange rebate programs?

We believe it is important to understand who at the exchanges has authority to enter into contracts for the provision of market information and on what basis they exercise that authority, what terms they negotiate, what discretion they have in this process, as well as the procedures they must follow in carrying out this function.

It is especially important for the committee to understand the terms of the various programs offered by some of the exchanges and Nasdaq to rebate market-information revenues to certain market participants (*e.g.*, to market makers). Whether negotiated individually or as part of a program, it is essential that the committee know what the standards are for participation in the programs and the standards that govern the amount of the rebates. It is also essential that the committee understand who is eligible to participate, how the rebate programs affect the general pricing of market information, and how the rebate programs impact the revenues received and kept by the exchanges and Nasdaq. How can the rebates be justified if an exchange claims that market-information revenues do not cover all costs associated with the production of market information? In addition, the committee needs to know whether other fees, such as booth fees or transaction fees, are offset by market-information fees.

Obtaining this information will help the Committee better understand the administrative process that market-information users must undergo in order to receive and use market information, the role of the network administrator in overseeing this process, and the administrative burdens associated with this process. It may also clarify some of the concerns raised by market participants that must negotiate contracts for market information with their governing self-regulatory organization(s).

- How many pricing pilot programs are there, how many market participants participate in them, and how are pilot programs' terms (including extensions) determined?

While there are indications that many pilot programs have been used to test various market-information fee structures, we have not been able to ascertain the exact scope, nature and number of such programs nor does it appear that these

programs are well understood by the Commission. As a result, it is unclear how widespread these programs are and how much they can impact the overall fees that are collected. For example, several years ago Schwab was involved in a pilot program, which we believed involved many other market participants. We subsequently learned that Schwab was the sole participant. Some of the current pilot programs effectively replace the original fee schedules, but they are subject to change or termination without notice. This precludes firms from being able to forecast their market data costs with any certainty. We believe that the terms, scope, duration, number of participants, and other facts surrounding administration of the programs must be disclosed before we can fully comprehend the costs and means for disseminating market information.

Obtaining this information will help the Committee determine the extent to which fees are fairly, reasonably and non-discriminatorily applied, and will also reveal the full amount of market-information revenues earned by the exchanges and Nasdaq. It may also further clarify the role of the administrators.

- How exactly does market data cross-subsidize other self-regulatory functions?

This is a critical point that needs clarification. Some have suggested that market-information fees should support self-regulatory functions. We disagree with this view because it is contrary to the Exchange Act and because other fees are more directly related to the operation of those functions. Nonetheless, any discussion or reasonable understanding of this issue is hampered by the lack of disclosure as to the specific services supported by market-information revenues. Further, we must also understand how the exchanges and the NASD use other sources of revenues.

Obtaining this information will enable the Committee to understand the way in which the exchanges and Nasdaq account for the market-information costs and revenues and how these revenues are used. It will also enable the Committee to evaluate whether market-information revenues are actually and reasonably used to support the self-regulatory functions.

- What are the systems, maintenance, and administrative costs the exchanges incur for aggregating and disseminating market data?

Any discussion or conclusion by the Committee on the fairness or reasonableness of the current fees must be based on accurate data about costs. To date, the exchanges have not made this information available in any usable or verifiable form.

We believe it is vital to the work of this Committee and the Securities and Exchange Commission that, at a minimum, we fully understand the answers to these questions. Without a complete understanding of the facts underlying the operation of the market-information plans, no one will be in a position to reasonably evaluate their fairness, reasonableness and objectivity. Without answers to these questions, modifications to the current system cannot be expected to cure the deficiencies of these plans.