

**Report of the Advisory Committee
On Market Information:
A Blueprint For Responsible Change**

September 14, 2001

Chairman Harvey Pitt
Commissioner Isaac Hunt
Commissioner Laura Unger
Securities and Exchange Commission
450 5th Street, N.W.
Washington, DC 20549

Via Fax: 202-942-9646

Dear Chairman Pitt and Commissioners Hunt and Unger:

On behalf of the Advisory Committee on Market Information, let me present our report, A Blueprint for Responsible Change. This Report was completed before the terrible national tragedy of September 11 and does not, indeed could not, take into account the implications of those horrific events on our discussion and recommendations.

Appropriately viewed this Report is the latest step in a two year Commission process. In December 1999 the SEC issued a Concept Release on the regulation of market information, which focused in detail on a proposal for a flexible cost based (or public utility type) approach to SEC market data fee regulation. The Release also addressed a variety of other market information issues including plan governance and public disclosure concerning fees and revenues. The 40 or so comments that the Commission received in response to the Concept Release reflected deep divisions in the securities industry on market information regulation. While most comments were skeptical of the detailed SEC proposed approach for a cost based limit or market information fees, there was sharp division on the fairness and reasonableness of existing fee levels. There was related division as to whether it was appropriate for market information fees to provide funding for other SRO functions such as market regulation. Views were also disparate on how much greater SRO and plan disclosure should be about market information; new concepts of plan governance (notably, whether vendors and subscribers should be members of plan operating committees); whether plan administration should be standardized; and whether the duration of pilot programs should be limited. Particularly significant in the comments to the Concept Release were proposals that more competition be introduced to the compilation and dissemination of market data.

In the summer of 2000 then Commission Chairman Arthur Levitt asked me to chair a 25 member Advisory Committee whose members represented a broad range of relevant economic interests concerning market information, including exchanges, ECNs, broker-dealers, retail and institutional investors, data vendors, and public representatives. This Committee was intended to include representatives of relevant divergent views.

Under its charter the Advisory Committee was asked to address:

- (1) the value of transparency to the markets; (2) the impact of decimalization and electronic quote generation on market transparency;
- (3) the merits of consolidated market information; (4) alternative

models for collecting and distributing market information; (5) how market data fees should be determined and evaluated; and (6) practical matters relating to the joint market information plans, such as appropriate governance structures and issues relating to plan administration and oversight.

Under our charter the Advisory Committee was limited in its scope, number of meetings, and its ability to engage in fact finding. Its purpose was to build consensus for recommendations to the Commission concerning market data regulation. As you will see, there is substantial support within the Advisory Committee for a number of specific recommendations. At the same time, there remain differences among Committee members on some issues. Our emphasis throughout our meetings and written communication was on open process and candid articulation of views. The text, footnotes, and separate statements of this Report describe the significant support for many recommendations and the differences of some Committee members on particular issues.

Our Report in essence today recommends:

- Price transparency and consolidated market information are and should continue as core elements of United States securities markets.
- A majority of the Advisory Committee favored the retention of the "Display" Rule 11Ac1-2, which requires vendors and broker-dealers to provide a consolidated display of last sale transaction reports and quotations from all reporting stock market centers.
- Market centers should be permitted to distribute additional market information such as limit order books free from mandatory consolidation requirements. This would permit such information to be customized for users or not distributed at all.
- A majority recommended that the Commission should permit a new system of competing consolidators to evolve from the current unitary consolidator model under which a single consolidator such as the Consolidated Tape Association receives and disseminates market information from all reporting market centers and distributes this information to vendors and subscribers. Under this recommendation each market center would be permitted to sell its market information to any number of competing consolidators, which, in turn, would sell to vendors and subscribers. This recommendation, however, is based on the Commission satisfying itself that specific technological and economic issues have been effectively addressed in any proposal for a competing consolidator.
- A minority of the Advisory Committee do not believe that the economic benefits of implementing a new model outweigh the technological and economic risks of the new competing consolidator model.
- The Advisory Committee generally agreed that if the Commission chooses not to adopt the competing consolidator model, it should adopt specific improvements to the existing model, including selecting the information processor by competitive bidding and broadening governance through a non-voting advisory committee.
- The Advisory Committee expressly rejected the proposal in the SEC December 1999 Concept Release for SEC review of market information fees under a cost based standard somewhat similar to a utility commission review of rates. The Advisory Committee recommends that the Commission continue review of relevant plans and fees under existing standards.
- With respect to options, the conclusions of the Advisory Committee were more tentative.

At the time of the Committee's meetings the capacity challenges for options market data were more daunting than for equities. A majority of the Advisory Committee supports the development of a consolidated display of the best bid and offer quotations from any options exchange and permission for competing consolidators to evolve. Both conclusions were more tentative than with equities. The discussion of competing options data consolidators recognized that it might be more difficult for the options exchanges to satisfy the Commission that the technological requirements of a new competitive consolidator model for options could be effectively addressed before this had been demonstrated in the equity markets.

In my personal view, the Advisory Committee Report is most significant in its recommendation of a new, more competitive structure for market information consolidation and a less regulatory approach to this aspect of the National Market System. To a large extent, each of the Committee's recommendations is a reflection of new possibilities created by the changes that have occurred in information technology since 1975, when the statutory basis for the current market was enacted. Technological change has already led to major changes in the securities markets, including decimalization, the development of electronic communication networks and alternative trading systems, global competition among exchanges, and faster trading cycles.

Technology is changing our securities markets so rapidly today that it would be wise for a more comprehensive study of securities market structure issues to be initiated. It is less important whether this study be conducted by the SEC Division of Market Regulation, a quasi-independent Special Study, or a staff study supervised by an SEC Commissioner. Each model has worked effectively in the Commission's history. What is important, however, is that there be an informed basis for SEC and Congressional decisions in the near future with respect to significant securities market structure issues. The rate of technological change has so accelerated in securities markets in recent years that such a study would now be prudent.

Such a study could more broadly address such topics as securities market linkage and order execution and such challenges as fragmentation of markets. There is an inevitable interconnectedness to securities market structure issues. The significance of a new approach to market information, for example, is influenced by such questions as whether payment for order flow and internalization is permitted; how orders are executed, how markets are linked, how markets compete, and what will be the impact of combining for profit and not for profit market center competitors. There is a similar interconnectivity to other securities market structure issues. While the Commission in day-to-day administration, as a practical matter, often has to address issues separately, the advantage of a periodic broader study is to appreciate how fundamental changes in securities markets should result generally in new policy.

Let me personally express my gratitude to a very hard working Committee for their participation in this process. Let me particularly express my gratitude to Georgetown University Law Professor Donald Langevoort who chaired a subcommittee on Alternative Market Data models; to Annette Nazareth, Director of the Division of Market Regulation; Robert Colby, Deputy Director of the Division of Market Regulation; David Shillman, Counsel to the Director of the Division of Market Regulation; Anitra Cassas, Special Counsel, Division of Market Regulation; and Mary Gallagher, Assistant to the Director, Division of Market Regulation. Anitra Cassas and David Shillman, in particular, deserve my special gratitude for their substantial efforts on behalf of the Advisory Committee.

Sincerely,

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* At the time the Advisory Committee was formed, Mr. Minister was President and CEO of Bridge Trading.
