FINANCIAL INFORMATION FORUM
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January 26, 2005

Jonathan G. Katz, Secretary
U.S. Securities and Exchange Commission
450 Fifth St. NW
Washington, D.C. 20549-0609

Re: Regulation NMS
Release No. 34-50870; File No. S7-10-04

Dear Mr. Katz:

The Financial Information Forum (FIF) appreciates the opportunity to comment on the above referenced reproposed new rules, which consider redesigning the existing National Market System (NMS) rules adopted under section 11A of the Securities Act of 1934. We sincerely appreciated the opportunity to testify at the Securities and Exchange (SEC) Hearings on NMS in New York City on April 13, 2004.

Formed in 1996, The FIF addresses the issues that impact the market data and securities processing industry - providing a collaborative environment for subscribers to benefit from technology, regulatory, and market innovations. FIF Subscribers include vendors of brokerage information and processing services, exchanges, ECNs, and broker-dealers. FIF is organized into committees that regularly meet to review relevant issues. The Market Data Committee addresses a wide range of issues related to the dissemination of market data. Another committee, the Market Data Capacity Planning Committee, focuses specifically on the issues of system capacity requirements as real-time peak message rates for market data continue to climb significantly. Members of the FIF Service Bureau Committee are service bureaus that operate real-time order systems and back office brokerage processing data centers for approximately 1500 broker/dealers. These committees have been involved with the review of this proposal, and their members have contributed to this letter.

The Proposed Regulation NMS opens the door to improvements in the U.S. equities markets. In this competitive environment, it is likely that most markets will introduce changes to enhance their efficiency and quality. While the market changes themselves are important, it is equally important that the changes be implemented in the industry’s information and transaction systems in an effective and efficient manner. It is important that the markets work interactively with brokerage industry firms and service providers when changes are planned. Traditionally the Securities and Exchange Commission also considers the impact of changes on the brokerage information system infrastructure when drafting filings for changes.

Our comments on Regulation NMS are based primarily on the perspective of market data vendors, their customers, exchanges/markets, and the service bureaus that provide computer-processing services to broker-dealers. The industry infrastructure for disseminating market data is complex and precise. When data or format changes are made, there is an impact on all downstream systems that receive and process this information in both real-time systems and historic databases. Service bureaus provide standardized systems as well as customized services and interfaces to meet the unique requirements of each client firm. When system changes are required, market data vendors and service bureaus must work individually with each of their clients to implement a program that includes software development, testing, training and migration of changes into production systems and brokerage operations. The service bureau environment, in many respects, is similar to the in-house systems of large broker-dealers. However it differs significantly in its need to deal with many different external organizations with different capabilities and business profiles. The implementation of any system changes in each of these multi-client environments must allow time for the various planning, development and operational rollout tasks.

The FIF submitted a comment letter on July 9, 2004 in response to the SEC rule proposals issued in February 2004 and also testified at the SEC hearings on Regulation NMS in New York in April 2004. Most recently, the FIF held a roundtable of its participant organizations in New York on January 20, 2005. At this meeting, representatives from the exchanges/markets, service bureaus, broker-dealers, and vendor organizations expressed their views on the proposed rules.

Our comments are as follows:

<u>Trade-Through Rule</u>

The SEC reproposed rules issued in December 2004 provide two alternatives. The first is the Market BBO Alternative which would protect the best bids and offers of the nine self-regulatory organizations and The NASDAQ Stock Market whose members trade NMS stocks. While this alternative extends regulatory requirements in a number of ways, it appears that the systems requirements for markets and broker-dealers to comply with the new rule would be achievable – although there would be significant capacity expansion and new linkages and processes needed for implementation.

The Voluntary Depth Alternative would also protect the BBOs of the SROs and NASDAQ and would also establish a mechanism for a market to secure protection for its depth-of-book (DOB) quotations at prices below its best bid or above its best offer. In examining the requirements of this second alternative, our participants have great difficulty envisioning the configuration and processes of the systems that would comprise the intermarket mechanism. Given the speed of today’s order and execution systems, there is serious concern as to how systems could interact in the environment of multiple price levels and rapid order changes originating from algorithmic-based order routing systems. Orders from markets choosing to protect depth quotes would have to be distinguished from depth orders not so protected. This could lead to significant investor confusion about why some orders are protected while others are not.

Some FIF subscribers believe the Voluntary Depth Alternative may be at odds with limit order protection generally. Investors would not necessarily know if their away limit orders deserved or received protection. The Voluntary Depth Alternative also presents the potential for a massive data management problem. Currently there is no source of the requisite information to determine whether a trade through might have occurred under such a scenario. It is not clear who would collect, store and conduct surveillance on depth quotes.

The DOB alternative would greatly increase the amount of real-time market data to be disseminated to the industry information infrastructure. Expansion of systems and network capacity would place significant additional costs on the markets, the consolidators, broker-dealers, vendors and investors. It is not clear that the additional costs would yield corresponding benefits to investors. Further, it is conceivable that such additional costs might further expand the information gap between the amount of data available to retail investors versus large institutional investors.

We suggest that the Voluntary Depth Alternative is a change of great magnitude with unknown potential for investor confusion, industry cost increases, and systemic risks. If the SEC decides to implement this part of the rule, it should not be implemented until further impact study is conducted and more definition of intermarket processes can be completed.

Market Access Rule

FIF concurs with the principle of fair and non-discriminatory access to markets. We note the Commission's statement that private linkages by a variety of connectivity providers might be utilized rather than a collective linkage facility such as ITS. We concur that developing such linkages in the private enterprise environment tends to be more efficient as opposed to defining a regulatory-driven mandate. On the other hand, we have seen the benefits that can result when an industry-wide effort is made to review and recommend the requirements and characteristics of core industry systems. FIF has participated in such industry-wide projects in the past and would be willing to be a part of a similar effort directed at market linkage system requirements.

Sub-Penny Trading Rule

We support the Commission's rule prohibiting market participants from accepting, ranking or displaying orders, quotations, or indications of interest in a pricing increment smaller than a penny (except for securities priced at less than $1.00). This rule will protect industry systems from significant data traffic that has little benefit to investors or to the industry.

Market Data Rules and Plan Amendments

1. Alternative Data Dissemination Models.

   We support the Commission's conclusion that the industry's market data consolidation and distribution systems have served the industry well and should not be altered without considerable study. These systems have been reliable and accurate and provide a high-quality, central resource for today's modern markets. At the same time, we understand the argument that a more competitive, market-driven approach is needed. Future developments in technology and operations may identify ways in which the industry can move from the current monopoly-like structure to a more competitive structure but such moves should not be made until the industry has carefully studied and identified the benefits and risks of such a change.

2. Level of Fees and Governance.

Fees

The Commission has appropriately addressed the issue of the abuses that were possible under the current Plan rules and has moved toward defining an approach that rewards markets for contributing to more liquidity and better execution. While the allocation calculation has been simplified in the Commission's December release, we feel that the calculation is still complex and subject to "gaming" by market participants who are eager to extract market data revenue shares by setting quotations at the BBO while simultaneously setting mechanisms to withdraw such quotes when it becomes likely that an order may be executed against them. This could lead to an unnecessary and burdensome number of spurious quotations onto already rapidly growing market data systems. It is not difficult to foresee how large quotation data rates would make it more expensive to receive and view the latest exchange prices and thus undermine the SEC's desire to benefit the private investor by making the viewing of the latest quotes viable only for institutions with deep pockets. We therefore urge the Commission to consider this area as it considers the matter of market data revenues in its separate study and rule considerations for self-regulatory organizations.

Plan Governance

Commenters have accurately observed that the rules of Plan governance have frequently worked against the Plans' attempts to adapt to changes in the markets and advances in technology. An overhaul as proposed is needed and appropriate. FIF participants have observed that the Plans have always reached out to the vendors and investment communities to share changes which they are considering and seek advisory input on the impact of such changes. Nonetheless, we feel it is appropriate to formalize this process by creating Advisory Committees that can routinely participate in deliberations regarding changes to policies, systems or procedures. While the Commission has defined the makeup of the Advisory Committee in terms of industry representation, we feel that further consideration is needed in determining specifically which organization will represent each industry segment given that they are, in most cases, competitors to each other. The Commission might consider an approach used by the NASDAQ UTP Operating Committee, which recently formed an informal Advisory Committee. In this case, the FIF serves on the committee as a representative for the areas of market data dissemination, order systems and brokerage processing.

3. Distribution and Display of Data

The Commission has made a prudent decision in permitting markets to distribute "non-core" data directly to vendors and users without requiring that the data be disseminated through the consolidator. Likewise, FIF supports the elimination of archaic vendor display rules and the requirement to display a full "montage" of the BBOs for each market. These changes relieve vendors and users of system and display requirements that were not significantly benefiting the industry. They also provide the industry with an opportunity to experiment and learn from the technical and operational experience of working with multiple market data feeds. This will be helpful in exploring the issues related to propagation delay effects in real-time systems.

General Considerations

Supplementing the specific comments made above, the FIF has additional comments regarding the proposed rules and their implementation:

Implementation Process and Timeframe

The brokerage industry infrastructure is complex and interactive. Over the years and, in the face of attacks and other disruptions, it has proven to be reliable, accurate and resilient. This is due not only to the design of the systems themselves but also to the cooperative nature of the industry's participating organizations as changes and improvements are proposed, designed, developed, tested and rolled into production. Changes are always accompanied by careful documentation including specifications and training of involved personnel.

Because of the high degree of complexity and interdependence, proposed changes must be carefully studied to identify all areas of impact – both intended and non-intended. Once an industry-wide change has been specified, each participating organization must design, develop and test its internal systems and procedures. Subsequent testing involves interconnected systems and, eventually, industry-wide testing. The processes of design, development and testing must take into consideration not only the functional changes required but also the consequences for systems and operational resilience and business continuity.

Another step in the process is the consideration of alternatives and contingencies that should be anticipated in the development process. For example, at our January 20 roundtable questions were directed at how the industry should respond when a particular market is having system or operational difficulties. With transaction rates so high hundreds, if not thousands, of erroneous trade reports may result from undetected system problems. Today's alert and remediation processes are lacking in this area. New and modern uniform processes for trouble reporting and data base recovery need to be developed.

Once the Commission makes its decisions on the specific requirements of Regulation NMS, we recommend that there be a process to assess their impact on industry systems and set adequate timeframes for the markets and industry participants to develop their plans and begin the change process.

Network and Systems Capacity Requirements

The U.S. financial markets have grown and prospered substantially since the introduction of National Market Systems regulations in the mid-1970s. Market data traffic and transaction volumes continue to grow at accelerating peak and daily rates, placing ever greater demands on the industry's computer systems and networks. It is clear that, as the industry moves from manual to electronic models for investment and trade execution, traffic and capacity requirements will continue to grow at a rapid rate.

The Commission has proposed the new rules from the perspective of creating fairer and more efficient markets. However, there is a cost to achieving these goals. While technology development has produced more effective automation tools at lower costs, it must be recognized that the overall cost of automation is increasing rapidly. The Commission must be concerned from two aspects:

1) Will the increased costs become an excessive burden and cause harm to the markets?

2) Will any investors be disadvantaged because of the increased costs?

Since its beginning in 1996, the FIF has focused on the technology, business and operational aspects of the industry's infrastructure. This included an analysis of the SEC Order Handling Rules proposed at that time and the ongoing data collection and analysis of peak message rate traffic from the industry's major markets. Users and vendors have benefited greatly from the empirical data that has been compiled and the process of summarizing future capacity expansion plans. FIF has become the industry's central resource for such information – not only for the data itself, but by providing a forum for technologists to share their views on growing system requirements.

Some aspects of the proposed Regulation NMS have the potential of greatly increasing systems and network capacity requirements. As the new rules are specified and as industry organizations begin to set their plans, FIF will continue to provide this planning resource to the industry. We suggest that the Commission consider two useful steps:

1) A phased process of implementation that will allow adequate time for design, development, and testing to optimize system performance and minimize systems risks.

2) The development of an "environmental impact statement" that projects how market data traffic rates may grow as a result of the changes.

We believe both of these will greatly facilitate the industry's transition to the new regulatory regime. The FIF will be happy to advise in this area as it has done over the years.

We hope that you find the above comments useful. We are sure that these important NMS discussions will continue and we look forward to participating in the dialog.

Respectfully submitted,

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