

To: Dean Joel Seligman, Washington University School of Law, and Members of The SEC Advisory Committee on Market Information

CC: Annette Nazareth, SEC Division of Market Regulation

Re: Submission on behalf of Datek Online Holdings Corp.

By: Edward J. Nicoll, Chairman & CEO

Date: December 5, 2000

I. Executive Summary:

The methodology for disseminating market data has emerged as one of the most important issues facing our nation's equities markets. Datek Online Holdings, through its subsidiaries The Island ECN, Inc. and Datek Online Brokerage Services, has been at the forefront of empowering investors by providing its customers with unprecedented levels of real-time market data. With the sweeping changes in our securities markets as well as the dramatic advancements in technology, we now have an opportunity to comprehensively address the issue of market data and further empower investors.

In light of this opportunity, Datek recommends an enhancement to the existing regulatory framework governing market data by permitting the creation of multiple securities information processors. By introducing competition and innovation to the market data regulatory framework rather than relying on a single monopoly processor, the Commission can best address its concerns regarding the availability of market data to investors. Under the Datek proposal, self-regulatory organizations ("SROs") would continue to be required to provide market data to one or more securities information processors ("SIPs") on a non-discriminatory basis. In turn, securities information processors or data vendors would be responsible for consolidating market data from the various self-regulatory organizations.

The following outline, organized in the order of the seven discussion points included in Dean Seligman's outline of suggested topics, describes the Datek proposal in greater detail.

II. Consolidators of Market Data

- 2.1 SRO Consolidators.** We propose that SROs, either singly or in combination, be required to provide market data (both last sale and quotation information) to all securities information processors on a non-discriminatory basis pursuant to an effective transaction reporting plan. SROs would continue to devise their own rules, subject to the customary SEC oversight, governing the collection of quotation and transaction information in its marketplace.

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- 2.2 Competing SIPs.** The elimination of the current convention of maintaining an exclusive SIP charged with consolidating market data from the various SROs is consistent with the House Conference Report to the 1975 amendments that states §11A does “not constitute a mandate for a single securities information processor at any stage in the processing of quotation or transactional data but merely recognized that where a self regulatory organization or organizations utilize an exclusive processor, that processor takes on the characteristics of a public utility and should be regulated accordingly.” H.R.Conf.Rep. No. 94-229 at 323 (1975).
- 2.3 Registration of SIPs.** The 1975 amendments provide for SEC registration of exclusive SIPs but not for a non-exclusive SIP unless the SEC “finds that the registration...is necessary or appropriate in the public interest...” §11A(b)(1). To provide the market place and the SEC with the assurance that SIPs perform their role in a manner that will secure the objectives of the Exchange Act, all SIPs should be subject to notice filings with the SEC upon the commencement of market data consolidation or dissemination.
- 2.4 SEC Filing Elements for SIPs.** An SEC notice filing process for SIPs might reasonably include at least the following elements:
- (a) SIPs shall disclose: (i) the identity, past business experience, and disciplinary history, if any, of its officers; (ii) the form of the business and the identity of the firm’s owners; and (iii) the facts relating to the existence of any ownership or other affiliation between the SIP and any SRO, market center or broker-dealer (“BD”).
 - (b) SIPs shall be permitted to offer market information services on unregulated terms and conditions.
 - (c) SIPs shall file with the SEC certain minimum descriptive elements of upon the commencement of any SIP service plan or amendment thereto. Such filings must include, for example, a description that would address the statutory requirements (i) that the form and content of the disseminated data is not “deceptive,” §11A(c)(1)(A); and (ii) that its publication exhibits “fairness and usefulness of the form and content of such information,” §11A(c)(1)(B).

III. Acquisition of Market Information by Consolidators

- 3.1 SRO-SIPs.** The SRO practice of obtaining all quotation and transaction data from their market participants in their role as market regulator in accordance with its own rules and subject to the customary SEC oversight would continue.

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- 3.2 Data Acquisition from SRO-SIPs.** An SRO's exclusive ability to obtain quotation and transaction data from its market participants via the use of its regulatory role necessitates that the terms whereby any SRO-SIP transmits the data to a competing SIP shall be on "fair and reasonable terms." Section 11A(c)(1)(C) establishes this standard for the acquisition of data by SIPs from any "exclusive processor of such information."
- 3.3 Creation of Consolidated Data.** Competing, independent SIPs would have the option of either consolidating market data from all SROs or only consolidating data from certain SROs and market centers. The necessity of including any one markets' data in the consolidated quote will thus be determined by the value of the data rather than any regulatory necessity. All SIPs shall be required to make adequate disclosures to their direct customers and investors concerning the data that has been both included and excluded (see section 5.2 infra).
- 3.4 Modification or Supplementation of SRO-SIP Data.** SRO-SIPs shall forfeit the protection of the current convention that has afforded them extensive approval power over how data vendors disseminate modified or supplemented SRO-provided data.
- 3.5 Deregulated Contracts for non SRO-SIPS.** Terms of pricing and cost recovery would not be specified and would be left to the market place and private negotiation.
- 3.5.1** At a minimum, non-SRO generators of quotation and transaction data (i.e. market makers, specialists and ECNs) may provide their market data directly to a requesting SIP (in addition to complying with its governing SRO reporting requirements) on any terms that it may reasonably determine. The terms of such dissemination contracts shall not be unreasonably discriminatory (see section 4.2 infra).
- 3.5.2** Through the creation of a "market" for market data, the sources of market information will be compensated on the basis of the value of their information. For example, markets providing faster and more informative quotation information may realize a greater value from such data than a market merely disseminating auto-quotes.
- 3.5.3** In a competitive environment SIPs might employ the strategies that have fostered competition between market centers. For example, a SIP could offer to pay based upon the number of quotes that establish a new inside market for a security. Similarly, SIPs might offer graduated pricing for quotations, paying more for quotes that have greater volume and less for quotes that merely add a small size increment at existing displayed quotation levels.

IV. Market Information Dissemination by Consolidators

- 4.1** There must be broad dissemination to brokers and investors, §11A(a)(1)(C)(iii), of market information.
- 4.2** Data must be available on “terms which are not unreasonably discriminatory,” §11A(c)(1)(D).
- 4.3** Minimum standards would not be set by regulation since market participants would be obligated to provide investors with the timely and accurate market information solely from competitive forces.
- 4.4** Since the Commission will no longer specify the minimum standards governing the contents of information disseminated by SIPs, a wider selection of market information at a spectrum of price points, dependent on the richness of the formatting and added value features, will flow from a competitive SIP marketplace.

V. Innovative Data Display Formats Shall be Encouraged

- 5.1 Market-based Standards.** The most efficient means of establishing data formatting standards is market acceptance. Any regulation-based standards setting approach necessarily poses a barrier to the operation of market innovation and the emergence of new technologies.
- 5.2 Disclosure-based Model.** SEC rules for SIPs shall prevent the dissemination of quotation and transaction data that is “fraudulent, deceptive” or misleading, §11A(c)(1)(A). Hence, the SEC should prescribe through a disclosure rule that data product features be accurately described and not materially misleading.
- 5.3 Permit Unconsolidated Data.** We intentionally omit any requirement that a SIP consolidate all market quotations provided that the nature and content of the data is fairly identified. Market centers shall be permitted to disseminate properly identified, unconsolidated market information on quotations and transactions within their own market
- 5.4 Invitation to Innovation.** As our markets confront decimalized trading, the integration of world markets and derivative markets for options and futures, data vendors shall be free to create and offer innovative products to the marketplace.

VI. Benefits of a Competitive SIP Model

- 6.1 The Goal of the National Market Act Amendments.** “New data processing and communications techniques create the opportunity for more

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efficient and effective market operations,” §11A(a)(1)(B). Under a competitive, partially deregulated SIP model the Exchange Act goal can be realized.

6.1.1 Today, multiple vendors already compete to deliver such efficient trading platforms that integrate data delivery, order entry, order management and smart routing by enhancing the basic output of the monopoly SIPs.

6.1.2 Nasdaq is developing SuperMontage to enter the market for enhanced data services by increasing the depth of market information they currently supply to investors. Similarly, the NYSE is seeking to develop its market data dissemination mechanism that also provides more depth of market information than currently provided. Thus, regulations are no longer necessary to require markets to provide market data to investors.

6.2 **Reduce Current Harmful Effects.** The current exclusive SIP model perpetuates conflicts of interest by permitting certain market centers to use their SIP status to their competitive advantage. A substantial benefit of a partially deregulated, competitive solution will be the introduction of market forces to reduce the anti-competitive, institutional advantages that SROs presently have the opportunity to exploit, to the detriment of would-be non-SRO competitors.

6.3 **Spur Market Efficiency.** Multiple processors will bring efficiencies to the process of collecting, consolidating and disseminating information by the operation of competition.

6.4 **Foster Distributed Marketplace Architecture.** The imperative today is distributed information networks and the avoidance of single points of failure. Competition among SIPs would create a market that had a more distributed architecture, greater distributed capacity, and a minimized exposure to a single point of failure.

VII. Investor Benefits from a Competitive SIP Market

7.1 All integrative displays of marketplace activity are a platform for trading, hedging and risk control decisions. There is a robust market for such decision tools that extends beyond institutions to sophisticated individuals.

7.2 By introducing competition to the market data business and removing regulatory strictures dating from an era where the costs of data consolidation and display favored a monopoly utility solution, market data will be available at lower prices.

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- 7.3** In order to ensure that the benefits of full inter-market competition flow to investors the SEC should replace the NYSE trade-through rule with a disclosure rule (as it has recently approved a trade-through disclosure rule in the context of OPRA, see “Firm Quote and Trade-Through Disclosure Rules for Options,” SEC Release No. 34-43591; File No. S7-17-00, November 17, 2000). At present the NYSE trade-through rule permits a slower market such as the NYSE to prevent a faster market from competing on the basis of speed of data and executions. Chairman Levitt has recently expressed his belief that the equities markets should consider a rule based upon the OPRA trade-through disclosure rule as “the most flexible and enduring way to promote efficient connections in our equities markets.” See Arthur Levitt, Remarks, SEC Open Meeting on Market Structure Initiatives <http://www.sec.gov/news/speeches/spch392.htm> (July 25, 2000).

VIII. Enhanced Best Execution Benefits from a Competitive SIP Market

- 8.1** The “economically efficient execution of securities transactions” is an objective of the 1975 amendments, §11A(a)(1)(C)(i). Achieving this objective at lower cost is the goal of introducing competition to the consolidation of data.
- 8.2** A broker’s duty of best execution will provide sufficient incentives for brokers to obtain reliable and accurate market data for itself and its customers.
- 8.3** Competition between markets with respect to market data will enhance competition between markets generally. Fostering competition between markets will, in turn, enhance the opportunities for BDs to capture better executions for customers.
- 8.4** The decimalized trading environment is characterized by more rapid trading at smaller size increments which necessitates new integrative displays of marketplace activity as a platform for trading, hedging and risk control decisions.
- 8.5** Broker-dealers, driven by the competitive opportunity that exists in best serving their customers, are rapidly exploiting technology and delivering “direct access” products that enable customers to select their own order routing. These same competitive forces will even more vigorously drive the market for market data if we remove the regulatory strictures dating from an earlier era.