

December 4, 2000

Dean Joel Seligman
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Dear Dean Seligman:

In your correspondence of October 26, 2000 to members of the SEC Advisory Committee on Market Information (the "Advisory Committee"), you requested written submissions regarding solutions for developing an alternative model for dissemination of market information.

In response to your request, Reuters Group PLC ("Reuters")¹ has set out below a preliminary overview of reforms that, in its view, merit consideration by the Advisory Committee in its efforts to enhance effective dissemination of market data for U.S. equity securities. Consistent with our understanding of your request, this submission does not attempt to describe a comprehensive and detailed set of regulatory reforms, but instead seeks to outline a framework to prompt further discussion by the Advisory Committee in its assessment of which "alternative models" for disseminating market information, if any, merit additional consideration.

Introduction

The Congressional mandate underlying creation of the National Market System encompassed a broad range of important policy objectives, including efficient execution of transactions, fair competition between market centers, enhanced availability of market information, the linking of market centers and a number of related goals.² The ability to achieve these objectives, Congress recognized, grew out of an essential and evolving factual predicate:

¹ Reuters supplies the global financial markets and the news media with the widest range of information and news products, including real-time financial data, historical and graphical databases, and news, news video, news pictures and graphics. Reuters also provides global solutions and technologies for the financial markets. Instinet Corporation, a global electronic agency broker that is a member of 20 exchanges around the world, is a wholly-owned subsidiary of Reuters and is vitally interested in these issues.

² See Securities Exchange Act of 1934, as amended (the "Exchange Act"), § 11(A)(a)(1)(C)-(D).

“*New data processing and communications techniques* create the opportunity for more efficient and effective market operations.”³

In the twenty-five years since adoption of the Securities Act Amendments of 1975 (the “1975 Amendments”), “new data processing and communications techniques” have dramatically advanced and enhanced the ability of the marketplace to achieve Congress’ original mandate. These advances include: (i) explosive growth in the availability of computer processing capability, (ii) creation of more rapid and continuous methods of communications among a broad range of market participants, and (iii) development of standard communications protocols that allow the creation of network architectures on a scale nearly inconceivable twenty-five years ago.

The effective use of new technology to achieve the goals articulated in the 1975 Amendments will, we believe, require significant changes in the current regulatory structure – and in that sense may call for an “alternative model” for dissemination of market information. Nevertheless, changes to the specific regulatory mechanism for implementing the statute should not be confused with a change to an “alternative” *policy* model. The 1975 Amendments did not “lock in” one particular structure for dissemination of market data. Indeed, the breadth and flexibility of the Congressional mandate to the Securities and Exchange Commission (the “Commission”) underscores the expectation that ongoing regulatory change would play an important part in recognizing the potential for new technologies to serve the markets and investors better.⁴

Central to achieving this objective, in our view, is recognition that continuing adherence to the “mainframe” technology model – embedded in the current system of “monopoly” data consolidators – will hinder, rather than enhance, efforts to achieve the goals established by Congress in 1975. Network technologies, now widely used in all markets, offer far superior opportunities to collect and disseminate market data – opportunities that cannot readily be realized under current regulations. Network technologies are already being used to make separate streams of order flow information visible to the marketplace. It is essential, we believe, that the existing regulatory framework be revised to permit markets and investors to achieve more fully the benefits that these new technologies can bring. The combination of technology and competition can ensure that the greatest degree of information flow is made available to the marketplace.

Central Elements of Regulatory Reform

At the core of any reform to existing regulatory structures, Reuters considers it critical to establish a framework that permits *competition* to flourish in the collection, consolidation and dissemination of market data. Commission-sanctioned data monopolies play

³ See Exchange Act, § 11(A)(a)(1)(B) (emphasis added).

⁴ See S. Rep. No. 94-75, at 12 (1975), *reprinted in* U.S.C.C.A.N. 179, 190 (noting that under the 1975 Amendments “the SEC’s basic role would be to remove burdens on competition which would unjustifiably hinder the markets natural economic evolution”); H.R. Conf. Rep. No. 94-229, at 92 (1975), *reprinted in* 1975 U.S.C.C.A.N. 321, 323.

an important role in today's markets, and may well have been necessary in the 1970s and 1980s to achieve the goals of the 1975 Amendments. Nevertheless, the explosive growth of the Internet and other communications networks in the 1990s confirms that technological constraints no longer require the existence of such monopolies to permit widespread and rapid information dissemination to occur. Moreover, many of the concerns regarding the existing market data system – that it costs too much, that it moves too slowly, and that it provides investors with data that they do not need⁵ – reflect the rigidity inherent in monopolistic regulatory approaches, approaches that in fact have been abandoned in one industry after another since the 1970s.⁶

In Reuters' view, the Advisory Committee should consider whether the time has arrived to adopt a wholly market-oriented approach to data dissemination. A serious argument can be made that, at present, continued substantive regulation of mechanisms for market data dissemination (apart from anti-fraud protections) may do more harm than good.⁷ Technological change in recent years has substantially increased the quantity of information available to investors and reduced its cost. While the Commission and the Congress have played a significant role in several important transparency and disclosure initiatives, to a significant extent the growth in information available has occurred (both in the securities markets and in other sectors) as a result of market rather than regulatory pressures.

Nevertheless, in recognition of potential concerns that the Advisory Committee and others may have with too-rapid deregulation of the market, we have sought to identify approaches to reform that will preserve key features of the existing system, while introducing elements of competition that can most effectively achieve the objectives established by Congress in 1975. Crucial elements of reform along these lines would, in our view, include: (i) mechanisms to ensure *consolidation* of essential market data, (ii) standards requiring non-discriminatory *access* to consolidated market data, and (iii) elimination of barriers precluding effective *competition* among multiple consolidators of market data or, at a minimum, creation of a truly neutral exclusive data consolidator chosen on competitive terms that do not favor "legacy" systems currently operated by SRO monopolies. Important additional considerations would include assessment of the need for Commission-mandated communications protocols, as well as minimum standards governing the adequacy of the response times and other aspects of consolidators' systems.⁸

⁵ Reuters continues to support reforms to the current system of data dissemination, as described in our comment on the Commission's Concept Release on Regulation of Market Information Fees. See Letter submitted on behalf of Reuters America Inc., by Devin Wenig to Jonathan G. Katz, Secretary, SEC, dated April 5, 2000 (suggesting that the system be made easier to administer and more flexible); letter submitted on behalf of Charles Schwab & Co., by W. Hardy Callcott to Jonathan G. Katz, Secretary, SEC, dated July 10, 2000, at 2-3; letter submitted on behalf of Securities Industry Association, by Marc E. Lackritz to Jonathan G. Katz, Secretary, SEC, dated April 11, 2000, at 4.

⁶ See Sharon Brown-Hruska and Jerry Ellig, *Financial Markets as Information Monopolies*, 23 REGULATION, at 29.

⁷ See *id.*; letter submitted on behalf of Fidelity Investments, by Eric D. Roiter to Jonathan G. Katz, Secretary, SEC, dated April 12, 2000.

⁸ A related and critical additional point that must be addressed is the relationship between market data consolidation and "securities information processor" functions relating to order interaction (e.g., under the

No single approach necessarily will achieve an appropriate balance between each of these features, as well as among the various other objectives of the 1975 Amendments. As discussed in greater detail below, however, adoption of an approach based on Commission-led efforts to permit competition among consolidators of market data appears both practicable and preferable to the existing monopoly approach. Moreover, we consider it feasible to implement this model without wholly uprooting existing market structures and through extension of principles already embedded in Commission regulations.

A Framework for Competition among Market Data Consolidators

In our view, the Advisory Committee should develop and refine a set of regulatory reforms that would enable competition to arise among multiple market data consolidators, consistent with the key regulatory objectives identified above. We consider adoption of reforms promoting competition to be the most effective way of assuring that investors will gain the benefits of technological and other innovations, both in terms of quality and cost. An additional major benefit of these reforms would include, we believe, reduction or elimination of the problematic policy choices and burdens on the Commission – and inefficiencies inherent in any approach that relies on “quasi-rate making” supervision of monopoly consolidators.⁹

How would a system based on competition work – especially if it is to achieve the regulatory objectives identified above? While the full exposition of the details of a system permitting competition among consolidators will undoubtedly require additional careful consideration by the Advisory Committee, we suggest that a useful “starting point” proposal would begin with the following elements:

1. *Multiple Potential Consolidators.* Commission regulations should expressly recognize the possibility of competition among market data consolidators, with eligibility open both to current consolidators and other entities.

Consideration preferably would be given to reforms that would enable multiple entities to act as consolidators (subject to non-discriminatory access requirements as described below). A serious assessment also should be made, however, of the implications of auctioning “exclusive” information processor status to a single entity selected from multiple firms (*e.g.*, based on who would provide the lowest price to subscribers consistent with appropriate quality and performance standards).¹⁰

Commission’s Order Handling Rules and Regulation ATS). In this connection, we believe that, particularly in light of the “legacy” issues noted above, it will be important in the first instance to establish a neutral and open industry facility for order interaction among exchanges, ATSS, and market makers, especially in the market for Nasdaq-listed securities.

⁹ See Letter on behalf of the Mercatus Center, by Wendy L. Gramm and Susan E. Dudley, to Arthur Levitt, Chairman, SEC, dated March 31, 2000, at 7.

¹⁰ See *Request for Proposals*, Canadian Securities Administrators (July 25, 2000); Roiter, *supra* note 7, at 2. Although SROs should be free to compete in such auctions, it is important to guard against regulatory entrenchment

2. *Minimum Commission Standards to Qualify as a Consolidator.* Any entity seeking to qualify as a consolidator would be required to meet minimum standards established by the Commission.¹¹ These standards should include:

- *Consolidated Data.* To assure that the investing public will continue to receive adequate consolidated data, consolidators would be required to disseminate consolidated market data meeting minimum requirements established by the Commission (*e.g.*, as to last sale and quotation reporting).¹²
- *Non-Discriminatory Access.* To ensure that every consolidator will have access to market-wide data (and thus to meet its obligation to offer “consolidated” market data), each consolidator would be required to make market data available to the marketplace – *including to competing consolidators* – on non-discriminatory terms.¹³

3. *Obligation to Submit Transaction and Quote Data.* All broker-dealers would have an obligation, as is currently the case, to submit appropriate transaction and quotation data to at least one consolidator recognized by the Commission. In contrast to current regulations, however, broker-dealers would be free to negotiate the most favorable terms available from a consolidator for their data.

4. *Subscriber Choice.* Subscribers would be free to purchase market data from any consolidator approved by the Commission – taking into account quality, speed and other features of the consolidator’s service, as well as its cost. Consolidators would have the ability to offer a broad range of data and services beyond the regulatorily-mandated minimum. By the same token, current vendor display rules should be reviewed to determine whether they provide investors with adequate flexibility to manage their systems and choose the information they wish to receive.¹⁴

of “legacy” systems operated by SRO monopolies (especially insofar as they have an impact on related systems providing for interaction and execution of orders).

¹¹ Consideration also could be given to additional standards supplementing those expressly noted above (*e.g.*, relating to response times and similar technical aspects of consolidators’ systems).

¹² Consolidators presumably would be permitted, if not encouraged, to provide additional data and services beyond the regulatory minimum. If incentives to innovate are to be preserved, care must be taken to ensure that innovations by one consolidator are not “captured” by competitors as part of the regulatory minimum.

¹³ In other words, if an exchange wished to qualify as a consolidator, it would be required to sell its data to competing consolidators on terms no less favorable than those on which it effectively provides that data to subscribers, exchange members and data vendors. In exploring the precise scope of this requirement, it may be useful to consider adoption of a “most favored nation” requirement that obligates a consolidator to offer data to its competitors on the most favorable terms offered to any subscriber or other recipient of data.

¹⁴ Rapid increases in message traffic are straining the capacity of systems of both information processors and end users. As the Commission is aware, this problem is most acute for options message traffic. The Commission recently amended the Options Price Reporting Authority Plan for Reporting of Consolidated Options Last Sale Reports and Quotation Information (“OPRA Plan”), to allocate scarce OPRA Plan systems capacity during peak usage periods. *See* Adoption of Amendments to National Market System Plan, Exchange Act Release No. 34-43621 (Nov. 27, 2000). The increase in equities message traffic is also of concern. Nasdaq has had to delay its

From a commercial and practical perspective, the proposed approach seeks to build upon two principal features: first, the obligation of each consolidator to provide competitors with non-discriminatory access to market data (thereby assuring that each consolidator will in fact have market-wide data reflected in its system) and second, the freedom of broker-dealers submitting data, as well as subscribers, to select among multiple consolidators (thereby creating potential incentives for new consolidators to create efficiencies by sharing revenue streams with broker-dealers that currently must give their information away for free).

Advantages potentially arising from the proposed approach would include: (i) assurance of availability of consolidated data satisfying minimum standards established by the Commission, (ii) a market for consolidated data that would create incentives for innovation and efficiencies – including the provision of additional data and services beyond the regulatory minimum – and potentially significant reductions in costs, (iii) elimination of the need for continuing “cost-based” or similar review of monopoly pricing by exclusive processors, (iv) enhanced investor choice, and (v) increased participation by broker-dealers and other market participants in building effective consolidation services. Moreover, the model could be implemented based on existing Commission rulemaking authority and the extension of existing regulatory principles (*e.g.*, the non-discriminatory access provisions of the Order Handling Rules and Regulation ATS).

Issues Raised for Consideration by the Advisory Committee

In your correspondence to the Advisory Committee, you raised a number of specific issues that any proposals for reform should take into account. The remainder of this letter seeks to address each of those issues briefly in connection with the proposal described above.

Who will act as consolidators?

Any SRO or other market participant or data vendor could act as a consolidator if it satisfied the minimum conditions established by the Commission. In our view, a number of existing SROs would be likely to continue to seek “qualified consolidator” status.¹⁵ In addition, Reuters considers it likely that a number of market participants and data vendors (including Reuters itself) would seek to serve as consolidators.¹⁶

implementation of decimal pricing due to capacity constraints. The capacity problem could be ameliorated by allowing investors greater freedom to manage their systems and choose the information they need.

¹⁵ For the reasons noted above, it would be important to ensure that SROs forgo any existing competitive advantages before being permitted to enter into competition with other entities.

¹⁶ In the event multiple entities do not seek to qualify as consolidators, the Commission could continue, as it does today, to regulate “exclusive” securities information processors. As noted in prior comment letters, there are a number of steps that Reuters suggests that the Commission consider if it continues to regulate “exclusive” processors under the current model. *See* Wenig, *supra* note 5.

How would the consolidators obtain market information?

All broker-dealers would be obligated to submit market information to at least one qualified consolidator. Unlike the current model that requires broker-dealers to submit their data without charge to an exclusive consolidator, the proposal would permit them to select the consolidator or consolidators that offered the most favorable terms for their data. This ability to choose is likely to create substantial incentives for increased innovation and efficiency among consolidators. For example, a consolidator operating a system that is more efficient or more attractive to subscribers presumably could, as an inducement to using its facilities, offer a higher portion of its revenue stream to broker-dealers than a less efficient or attractive system.

An important component of the proposed approach – arising out of the regulatory objective of establishing minimum standards for consolidated data – is the additional requirement that every qualifying data consolidator must provide *competitors* with non-discriminatory access to its data.¹⁷ This requirement, comparable in many respects to the non-discrimination rules established by the Commission in other contexts (*e.g.*, Regulation ATS), would not entail regulatory entanglement in price-setting. Instead, if a consolidator chooses to sell any of its data to subscribers, it must provide that data on no less favorable terms to competitors. Notably, it may be possible to structure the non-discriminatory access requirement in a manner that will create incentives for consolidators to offer the data on somewhat more favorable terms to competitors – since they will have a reciprocal obligation to acquire data from each consolidator to whom they are selling.¹⁸

The Advisory Committee may wish to consider whether the requirement of non-discriminatory access should be reviewed on a continuing basis. As noted above, market forces have greatly increased access to market information without the need for regulatory intervention. Nevertheless, U.S. markets have long been operated under an “exclusive” consolidator model and the potentially anticompetitive impact of existing monopolies may take some time to dissipate.

How would consolidators make market information available to users and under what terms?

Consolidators would make market information available to users in a form that would be subject to minimum standards established by the Commission. For example, to the extent the Commission requires that users receive timely consolidated last sale data from the principal trading markets for the security, each consolidator would be obligated to provide that

¹⁷ As discussed below, the Commission potentially could play a constructive role in establishing communications protocols and related requirements to be met when providing data, either to subscribers or competitors.

¹⁸ If the Advisory Committee determines to pursue the proposed approach, it will be important to consider carefully the details of the concept of “non-discriminatory access.” In particular, a variety of methods could be explored to preclude one competitor from “monopolizing” access to data that is submitted to it. The antitrust laws, among other precedents, could provide useful precedents for consideration. *See, e.g., Entering the 21st Century: Competition Policy in the World of B2B Electronic Marketplaces*, Federal Trade Commission Staff (October 2000).

data to its users on a timely basis. At the same time, a consolidator would have the ability to supplement its data and to provide additional services to users.

Each consolidator would be free to establish the terms on which it proposes to make data available to users. This would promote beneficial price and service competition currently absent from the marketplace. At the same time, the non-discrimination requirement noted above would be designed to reduce the risk of monopolistic practices and to ensure broad access to data among investors.

In what standardized format, if any, would data be made available?

The Commission would, under the proposed approach, have the authority to mandate (or reserve the right to mandate) use of standardized formats for dissemination of data. In our view, however, it likely would prove unnecessary for the Commission to implement such authority.

Standardized communications protocols, such as FIX, have become well-established in the financial markets and are likely to improve over time. Indeed, significant linkages based on these protocols already exist among many market participants. While Commission intervention could play an important role in some circumstances, the need for action may be limited. Moreover, Commission regulations establishing consistent industry standards (*i.e.*, setting the width of the railroad tracks) are likely to be far simpler and less intrusive than efforts to oversee the cost structure and responsiveness of the monopoly SROs on which the markets currently rely.

How will investors be assured of receiving accurate, real-time consolidated information?

As noted above, the Commission could supplement competition among consolidators by establishing minimum response times and accuracy requirements for meeting the needs of investors. Consolidators failing to meet minimum response time standards should lose the ability to require that their data be included in information disseminated by competitors (and, if persistently unable to supply data in a timely fashion, should lose "consolidator" status). In our view, competitive forces will tend in any event to push consolidators to provide accurate and timely consolidated information.

Indeed, experience of recent years suggests that it is precisely the absence of competitive pressure on SROs acting as exclusive processors that has most significantly retarded improvements in dissemination of market data. Delays in implementation of decimal trading and flaws in operation of the options markets are among the recent examples of monopoly data providers lagging substantially behind the competitive marketplace – notwithstanding the expansive authority and vigorous oversight of SROs by the Commission.¹⁹

¹⁹ See Order Staying the Deadlines for Decimal Implementation, Exchange Act Release No. 34-42685 (Apr. 13, 2000); Certain Activities of Options Exchanges, Exchange Act Release No. 34-43268 (Sept. 11, 2000).

How will brokers satisfy their best execution responsibilities?

Brokers will satisfy their best execution responsibilities just as they do today – by reviewing the full range of execution opportunities available to their customers and reassessing their procedures on an ongoing basis. Because the model contemplates, at least at the outset, a continuing stream of consolidated data, brokers' ability to implement their best execution procedures would not be impaired – and indeed are likely to be enhanced through increased incentives for data consolidators to create and offer users software and other tools to measure execution performance more effectively.

Why is the model preferable to the existing model?

Developments in communications technologies have made the existing monopoly system unnecessary to achieving the objectives of the 1975 Amendments. Indeed, those monopolies have arguably come to represent an impediment to flexibility, innovation and efficiency in achieving the policy objectives of the statute.²⁰ As Congress recognized in 1975, moreover, the Commission must aggressively guard against potential abuse of monopoly status, including through the potentially intractable problem of guaranteeing the "reasonableness" of the charges of "exclusive" securities information processors.²¹

The introduction of competitive forces – widely recognized as more effective than utility-style regulation throughout the economy – will significantly increase the potential for innovation and efficiency improvements in the dissemination of market data. Moreover, the 1975 Amendments themselves expressly acknowledged the importance of protecting competition among Congress' goals.²²

The approach proposed for the Advisory Committee's consideration would, at the same time, continue to assure the markets of a continuing stream of consolidated data – and preserve minimum standards governing market data consolidators, at least until confidence grows that the marketplace will achieve these objectives without further regulatory intervention.

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²⁰ See Gramm and Dudley, *supra* note 9, at 7 (arguing that entrepreneurial incentives are stifled under a market monopoly system).

²¹ See H.R. Conf. Rep. No. 94-229, at 87 (1975), *reprinted in* 1975 U.S.C.C.A.N. 321.

²² See H.R. Conf. Rep. No. 94-229, at 92 (1975), *reprinted in* 1975 U.S.C.C.A.N. 321, 323.

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We appreciate the opportunity to offer our views to the Advisory Committee on potential reforms to improve data dissemination in the U.S. equity markets. We look forward to discussing the proposed reforms outlined above, as well as those offered by other Advisory Committee members, at the December 14, 2000 Advisory Committee meeting. If you should have any questions or would like to discuss any aspect of this letter, please do not hesitate to contact me at (212) 593-5500 or Mitchell Feuer, Reuters America Vice President for Government and Regulatory Affairs, at (202) 898-8343.

Sincerely,

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cc: Annette Nazareth, Esq.