



February 28, 2001

**VIA ELECTRONIC MAIL**

Professor Joel Seligman  
Dean and Ethan A.H. Schepley University Professor  
Washington University School of Law  
Campus Box 1120  
1 Brookings Drive  
St. Louis, MO 63130-4899

**Re: Responses to Questions Concerning Archipelago's Proposal to Update the National Market System**

Dear Professor Seligman:

Archipelago L.L.C. ("Archipelago") appreciates the opportunity to provide additional information concerning the "ARCHIPELAGO PROPOSAL TO UPDATE THE NATIONAL MARKET SYSTEM" as presented to the Securities and Exchange Commission ("SEC") Committee on Market Data ("Proposal"). Our responses to the questions raised by the Committee and Division staff appear below.<sup>1</sup>

**I(a) Your model contemplates that the exclusive SIPs, at least temporarily, will continue to consolidate real-time best quotation and last-sale information. It is unclear, however, whether vendors and broker-dealers would continue to be required to provide this information to their customers. What are your views on this, both in the short-term (with exclusive SIPs) and in the long-term (once exclusive SIPs no longer are needed)?**

Market participants will continue to value consolidated real-time market data because this data is integral to the decisions made by investors every trading day (e.g., the pricing of orders, price discovery, etc.) We have no doubt that the demand for consolidated data will be met by vendors and broker-dealers. As you know, our Proposal sets forth the view that vendors and broker-dealers should not be limited to providing *consolidated* data. Instead, vendors and broker-dealers should be afforded the opportunity to supply *non-consolidated* data under certain conditions.

Under the Archipelago Proposal, the current intermarket consolidation plan ("e-SIP") will remain the source for consolidated market data in the short term. Vendors and

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<sup>1</sup> See Letter to Gerald Putnam, CEO, Archipelago, from Annette Nazareth, Director, Division of Market Regulation, SEC, dated January 5, 2001.

broker-dealers will be permitted to display non-consolidated data provided by one or more market centers (or any other market data providers) directly. Allowing the choice of displaying consolidated or non-consolidated data will necessarily require modifications to the current requirements of SEC Rule 11Ac1-2 (the “Vendor Display Rule”).<sup>2</sup> We recommend that the Vendor Display Rule should be modified to permit vendors and broker-dealers the opportunity to provide real-time last sale and bid/ask information without requiring the display of the *consolidated* last sale and the NBBO. Where a vendor or broker-dealer provides non-consolidated data, however, the data will be presented with appropriate disclaimers similar to those that now appear for delayed market data.

In the long term, we believe that the consolidation of data should be open to competition. We envision a regulatory environment (analogous to that adopted under Regulation ATS) where those vendors who wish to consolidate data from the market centers must meet certain requirements (e.g., fair access, capacity, sources of data, etc.).<sup>3</sup> Once these requirements are met, the vendor would qualify as a provider of consolidated data competing with other vendors of consolidated data.

**I(b) If you believe the requirement to provide consolidated data should cease, please respond to each of the questions asked the NYSE under the heading, “If you believe that consolidated data need not be provided.”**

Our responses to the NYSE’s questions appear in Appendix A. We wish to emphasize that ensuring investors fair access to consolidated market data should be one of the principle tenets in the regulation of the U.S. securities markets. The best way to achieve fair access to consolidated market data is to promote competition among providers of market data rather than to protect a single provider.

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<sup>2</sup> For example, SEC Rule 11Ac1-2(b) requires that if a vendor displays transaction reports or last sale data, such vendor must also provide a consolidated display of transaction reports or last sale data. In addition, SEC Rule 11Ac1-2(c) requires that vendors displaying quotation information with respect to reported securities and certain other securities on interrogation devices must display, at a minimum, a consolidated best bid and offer derived from quotations from all reporting market centers

<sup>3</sup> Archipelago believes the equivalent access standards are necessary to prevent vendors that control a substantial portion of market information from using such information to limit the growth of competitors.

<sup>4</sup> Archipelago believes the equivalent access standards are necessary to prevent vendors that control a substantial portion of market information from using such information to limit the growth of competitors.

<sup>5</sup> Archipelago fervently believes that coincident with changes to the Vendor Display Rule, the voting requirements for market data rates and services must change. In particular, because modifications to the Rule would enable an individual SRO to sell its market information, such SRO would have incentives for consolidated information—relative to its own information—to be prohibitively expensive.

**II. Do you contemplate the SEC continuing to exercise oversight with respect to the fairness and reasonableness of fees charged by the competing Information Collectors, both before and after exclusive SIPs are necessary? If not, what would govern the fees charged?**

The level and manner of SEC oversight will depend on whether the collection of market data is open to competition. If competition exists among those entities collecting and disseminating information, rates will be determined from the natural forces of supply and demand. Accordingly, in a competitive environment, the need for SEC oversight will be limited to setting minimum standards for Information Collectors (fair access, capacity, reporting requirements, etc.) In contrast, if a single entity or governing authority is granted exclusive control over the collection of market data, SEC oversight will be necessary to ensure appropriate access and fees for market data.

**III. Would SEC oversight of Information Collectors be required to ensure the accuracy and reliability of their data?**

Each Information Collector should be required to demonstrate to the Commission the entity's ability to perform the required functions of an Information Collector. As mentioned earlier, the SEC could require a regulatory scheme analogous to Regulation ATS, requiring each entity to meet minimum standards before operating.

Additional SEC oversight will not be necessary to ensure the accuracy and reliability of data if in fact there is bona fide competition among Information Collectors. If an Information Collector does not provide reliable data, vendors will not pay to obtain the data. In other words, natural competitive forces will provide incentives for Information Collectors to maintain data integrity.

**IV. At what point do you believe the exclusive SIPs can be eliminated? How would the judgments be made that degradation of information and fragmentation will not occur? Would the SEC retain the option to re-regulate if they did?**

Market competition should determine whether and when e-SIPs should be eliminated. If new Information Collectors enter the market and provide valuable services, market participants may subscribe to these competitive services either in addition to or in lieu of e-SIP services. If subscriptions to e-SIP information diminish to the level where market data revenue cannot cover costs, the e-SIP should be eliminated. Clearly, subscriptions to e-SIP data will diminish only if other Information Collectors are providing superior services. Thus, if the e-SIP cannot compete effectively, it is likely that the marketplace will have found an alternative source of reliable, consolidated information. Nevertheless, the Commission should retain the authority to regulate the marketplace for consolidated information in the event that competitive forces are unable to meet the demands for market data information.



**V. Please describe in more detail the duties or liabilities an SRO “sponsor” would have with respect to a non-SRO market center’s direct participation in a national market system plan. Could a specialist on one exchange be “sponsored” by another exchange?**

For the purposes of compliance with marketplace rules, a sponsored-participant’s activity will be regulated as the SRO sponsor’s activity. An SRO sponsor will be liable for all market-related activity of the entities it sponsors in the national market system.<sup>6</sup>

Although the sponsored participant will have a direct linkage to the national market system (“NMS”), the operation of that linkage will be contingent upon SRO sponsorship. If the SRO determines that its sponsored participant violates the terms of the mutual agreement, the SRO will have the authority to request that the central NMS processor discontinue the sponsored participant’s connectivity to the NMS.<sup>7</sup> Similar to today’s environment, a market participant will be permitted to participate in the NMS via separate SRO sponsors.

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Should you require additional information concerning our views, please do not hesitate to call me at (312) 442-7070. I look forward to discussing this proposal with you at our future Advisory Committee meetings.

Very truly yours,

ARCHIPELAGO, L.L.C.

A handwritten signature in black ink, consisting of several overlapping loops and a long horizontal stroke extending to the right.

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Gerald D. Putnam  
Chief Executive Officer

cc: Annette L. Nazareth  
Director, Division of Market Regulation, SEC

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<sup>6</sup> Archipelago considers activity covered by the ITS/CQ/CTS plans and the OTC UTP plan to be “market-related activity.”

<sup>7</sup> Because of the nature of the relationship between an SRO and its sponsored participant, the SRO sponsors will not have incentives to discontinue connectivity unless the SRO itself is at risk of being withdrawn from the NMS due to violations by its sponsored participant.

## **Appendix A: Responses to Additional Questions**

**I. If consolidation were optional, how would this impact the best execution obligations of broker-dealers? If a broker-dealer elected to receive market information only from the largest market center, could this be sufficient for best execution? Or is the concept of best execution meaningless with an NBBO? And what impact would this have on investors? If, for example, retail online investors were provided quotes from only one market center—that might have prices well away from the best—would they regularly and unwittingly trade at inferior prices?**

Any measurement of best execution should depend on consolidated prices rather than individual market center prices. Accordingly, in the short term, best execution will be measured based on the e-SIP's information.

As competitive Information Collectors develop, however, it is possible that data consolidation will occur outside the e-SIP. If the marketplace reaches this state, the best execution obligations of broker-dealers should be measured based on one of two data sources. If the broker-dealer uses information from a vendor that consolidates all market information (either from the e-SIP or from a competing Information Collector) the broker-dealer's best execution obligations should be based on data from its vendor. If the broker-dealer does not use consolidated information, its best execution obligations should be based on data from the e-SIP.

With proper disclosure, investors will not unwittingly trade at inferior prices.

**II. If users were permitted to pick and choose the market centers from which they receive information, some might decide to pay for data only from the largest market center in a security. If this became prevalent, what would the competitive impact be on the smaller market centers? Would they be able to survive? Would it be feasible for new competitors to emerge? Or would this lead to monopolies in the trading of individual securities? And what would this do to incentives to innovate, improve execution quality and reduce trading costs?**

In general, Archipelago believes that any vendor in the business of collecting and disseminating information from multiple market centers will likely accept information from any market center; an increase in information will likely serve to increase the economic value of a vendor's information.

We recognize, however, that the economic gain due to including information from an extremely small market center may not cover a vendor's cost of collecting such information. This problem can be resolved by including a requirement in the Vendor

Display Rule that vendors accept information from any market participant that wishes to submit information to that vendor.<sup>8</sup>

**III. How can the SEC assure best execution and efficient price discovery without mandatory consolidated market information?**

As mentioned above, the e-SIP will likely not disappear unless there exists a competitive marketplace that consolidates information.

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<sup>8</sup> Archipelago recommends that market centers be required to cover their costs of submitting market data to a vendor.