

NYSE's Responses to SEC Questions regarding
Competing Consolidators Model

By letter dated January 5, 2001, Annette Nazareth relayed Dean Seligman's request that NYSE respond in writing to certain questions regarding the competing consolidator model that NYSE proposed as an alternative to the current model in the December 1, 2000, letter from Robert G. Britz to Dean Seligman (the "Competing Consolidators Letter"). This Appendix A to NYSE's statements of position on the agenda items for the March 1, 2001, meeting of the SEC's Advisory Committee on Market Data (NYSE's "Agenda-Positions Letter") responds to those questions.

Question:

Under your model, would market centers other than SROs - such as ECNs, market makers and exchange specialists - be permitted to sell their data directly to vendors and data feed providers? If not, please explain why you believe the NYSE, for example, "owns" this data? Does the same rationale apply in the Nasdaq market?

NYSE Response:

In responding to agenda item I, the Agenda-Positions Letter explains that NYSE has no view regarding whether non-SRO market centers should be permitted to sell data directly to vendors and data feed providers outside of the data-dissemination consortia, as long as the regulatory scheme provides a level playing field.

Question:

Your model continues to rely on SEC oversight to ensure that each market's fees are fair and reasonable and not unreasonably discriminatory. What standards do you believe the SEC should use to make judgments as to the fairness and reasonableness of fees? Will this avoid the various problems with "government utility rate-making" you described in your comment letter to the Market Data Concept Release?

NYSE Response:

As our response to agenda items III and IV make clear, the NYSE's proposed model does not rely on SEC oversight. Instead, NYSE's proposal carries forward, and removes consortium interference with, the reliance on constituent governance that Congress legislated in 1975. Thus, the SEC should continue to discharge its responsibilities for overseeing the SROs' dissemination of market data in the same manner as it has overseen all SRO access and

pricing matters for the past 26 years. However, it will be free of the “referee” responsibilities it has had to assume from time to time in respect to disputes among consortium SROs.

Question:

Should a market be permitted to impose restrictions on the recipients of its data, such as prohibiting them from making markets in the securities for which information is provided? If so, please justify the anticompetitive impact.

NYSE Response:

We understand these questions to express no concern with limitations on retransmission that require compliance with vendor-type contractual terms. With that understanding, NYSE’s view is that a market should not restrict how a data recipient uses market data. However, note that differential pricing in accordance with the way data is used is a reasonable discrimination and an appropriate and long-established means for a SRO to allocate costs among its users.

Question:

By multiplying the number of direct data providers, won't your proposals introduce inefficiencies into the system? After all, vendors will be negotiating and servicing more contracts, the SEC will be reviewing more fee arrangements, and more parties will be consolidating the same data.

NYSE Response:

Regarding the proliferation of contracts, NYSE stated in the Competing Consolidators Letter (at footnote 15):

Under the extended competing consolidators model, the resulting change from joint contracts to individual exchange contracts could theoretically result in an increase from today’s three sets to nine (11, taking into account the NASD and the International Securities Exchange, which is the sole options exchange that is not also a CTA/CQ Plan participant). However, if the industry's experience regarding the high level of conformity among the exchanges’ rule books is predictive, those three sets would serve as models for all the exchanges, and the regional exchanges would tend to follow subsequent modifications to the three sets that the primary exchanges make.

This theoretical increase represents the worst case scenario. If regional exchanges continue to band together, such as by continuing to participate in CTA after NYSE’s withdrawal, fewer contracts would be necessary.

Regarding SEC review, we note that the SEC already reviews each other type of fee of each SRO. No one has suggested that the SROs should form a consortium for joint SRO levying of transaction fees as a means of addressing the SEC's workload.

As for the portion of the question regarding the increase in the number of parties consolidating market data, the Competing Consolidator Letter points out that the costs incurred by the competing consolidator appear relatively small. “The joint costs of the collection, consolidation and dissemination functions are modest relative to the overall costs of producing and disseminating market data, and it appears that the unbundling of consortium costs may not raise them at all.” (Competing Consolidators Letter at pp. 11-12; see, also, Competing Consolidators Letter at pp. 6-7.)

In any event, NYSE believes that the question is academic. We do not believe that the Commission can make a finding today that the 1934 Act purposes that joint activity serve outweigh the competitive burdens of joint activity. (See, for example, footnote 23 of the Competing Consolidators Letter.)

Question:

Your model explicitly is neutral on the issue of whether consolidated data must be provided to customers [fn. 12]. Does the NYSE have a view on this?

NYSE Response:

Please see our response to agenda item I in the Agenda-Positions Paper.

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NYSE answers the following questions because NYSE’s competing consolidator model contemplates that consolidated data displays should continue to be provided.

Question:

How will the SEC be assured that each of the competing consolidators is providing an accurate, reliable, and timely NBBO and last sale data? Your proposal raises the possibility of SEC regulation for non-exclusive SIPs. Please discuss your thoughts on this.

NYSE Response:

As the Competing Consolidator Letter explains (at pp. 10-11), the risks that could arise from NYSE’s competing consolidator proposal regarding accuracy, reliability, and timeliness are few, identifiable, familiar, extant in the current distribution chain and able to be mitigated: “today’s technology permits multiple entities to receive simultaneously multiple streams of data and to create consolidated outputs that sequence prices and quotes in the same order.”

The letter points out four types of risk -- different operating environments, different validation tolerances, separate capacity requirements for each consolidator and different protocols and data formats -- that a multi-consolidator environment will introduce, each of which is already present for data feed providers, vendors and other recipients. As the letter explains, CTA/CQ Plan resolutions of those issues are likely to carry forward under NYSE's proposal without intervention and market forces are likely to mitigate other disparities. As the letter also notes, standard setting, either through a trade group, contractual undertakings or, if necessary, direct SEC regulation, could intervene if additional regulation becomes necessary.

As NYSE sought to convey, NYSE does not believe that the need for SEC intervention is very high. The staff of the Securities Industry Automation Corporation would be pleased to meet with other Committee members and the SEC staff, or with Professor Langevoort's subcommittee on alternative models, to facilitate an assessment of the risks that could arise from NYSE's competing consolidator proposal regarding accuracy, reliability and timeliness, and how to mitigate these risks. We believe that the SEC will have to play no more than a reserve role.

Finally, we wish to note that deregulation always carries risks and costs in the nature of those that this question identifies. But here their impact is marginal and they are far more predictable than most since the U.S. securities industry is the exception in the world. The U.S. commodities futures industry and the rest of the world's securities and commodities futures industries have never been regulated in this fashion, thus presenting a \$6.0 billion dollar industry in which competing data-feed providers pick up feeds from scores of exchanges that independently price, and contract with respect to, market data. The U.S. exception at the production (SRO) level represents only about \$600 million (i.e., ten percent) of this experience base.¹

Question:

If certain market data is required to be consolidated, should the price the individual markets are permitted to charge for it be more tightly controlled? In other words, won't a requirement to obtain data from every market encourage price-gouging?

NYSE Response:

See the Competing Consolidator Letter (pp.10 and 12), the letter from Robert G. Britz to Members of the SEC Advisory Committee on Market Data dated February 8, 2001 , and our response to items III and IV to the Agenda-Position Letter. Under NYSE's proposed model, the same forces that have prevented NYSE from exploiting any latent market power over the past seven decades will discipline NYSE's market data fees.

¹ We do not mean to trivialize the importance of the absence of sequencing trades and selecting the best quote from the majority experience.

In addition, the injection of competition should also discipline pricing. As the Competing Consolidator Letter points out,

NYSE would compete with the other eight exchanges in the market data arena, just as it competes today with the other eight exchanges in individually in attracting listings and liquidity. Similarly, data feed providers would compete as to consolidation services, just as they do today as to other services.

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NYSE does not respond to the remaining questions because NYSE's proposed competing consolidator model provides for the continuation of consolidated displays and, as discussed in our response to agenda item I, we have not yet come to a view on the disposition of the Display Rule.²

² The remaining questions apply "If you believe that consolidated data need not be provided:"

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 without 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?

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?

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