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February 15, 2001

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

Re: Comments on March 1 Agenda for Meeting of SEC Advisory Committee on Market Information

Dear Dean Seligman:

By your January 18 email forwarding the captioned agenda, you requested that we send to you our views on the alternatives that the agenda presents. This letter provides our responses. In that connection, I would like to express my appreciation for the several clarifying changes that you made in preparing the final agenda in response to our January 12 comments on the January 5 agenda draft.

In response to the specific questions addressed to our competing consolidators model, we have attached **Appendix A**. Finally, the NYSE would appreciate the opportunity to serve on the subcommittee to be chaired by Professor Langevoort on alternative models.

For ease of your review, we briefly summarize below each agenda item and then provide our responses.

ITEM I. MANDATED DISPLAYS

This agenda item addresses two issues:

- Whether to change the current display requirements.
- Whether to regulate data that is not subject to the display requirements.

Changing the Current Display Requirements

We believe that the availability of the consolidated last sale and the NBBO (a “consolidated service”) to securities professionals and investors who seek consolidated data for business reasons or in compliance with their best-execution or other regulatory and fiduciary responsibilities remains vital to intermarket competition. The SEC has assured that availability at the “production” level by requiring, in essence, that SROs report quotes and trades and by approving SRO consortia that create consolidated feeds. It has assured that availability at the “distribution” level by precluding broker-dealers and vendors from providing individual market services without also providing consolidated services.

As we explained in our December 1 letter to you, we are confident that the SEC can remove the consolidation requirements at the production level without impairing the availability of consolidated data. As to those requirements pertaining to joint contracting, joint pricing and revenue sharing, removing them poses zero risk to the availability of consolidated data. From a systems standpoint, the competing consolidators model does have some risks as to its accuracy, reliability and timeliness, but they are few, identifiable, familiar, extant in the current distribution chain and able to be mitigated. At the production level, we believe we are especially capable of assessing these risks since the NYSE along with our affiliate, the Securities Industry Automation Corporation (“SIAC”), have perhaps more firsthand institutional knowledge than any other organization.

On the distribution level, we have discussed internally the spectrum of possibilities between preserving the display rule as it is today and removing it altogether. Possibilities within the spectrum include converting it from a must *display* (“push”) rule to a must *offer* (“pull”) rule (i.e., any vendor or broker-dealer who makes available any markets’ last sale prices and quotes also must *offer* a consolidated service). We also recognize that any relaxation of the current rule introduces a greater degree of market discipline by requiring SROs to compete in presenting a value proposition for their data.

But we do not yet believe we are capable of determining whether relaxing the rule will, in fact, impair the availability of consolidated data. At the distribution level, we do not have any unique institutional experience to make the requisite risk/reward calculation. We look forward to evaluating the thoughtful commentary on this agenda item of Committee representatives who are more directly involved at the distribution level.

Regulating Other Data

We recommend that any consideration of regulating other data beyond the current requirements of section 19(b) (requiring SROs to file with the SEC substantive rules and price changes) and of the SEC’s Automation Review Policy (“ARP”) should await experience with the SROs’ voluntary and competitive dissemination of such data. The SROs should be given a chance to demonstrate that, as is currently the case for all other

SRO activities except last sale prices and quotes, markets can competitively differentiate themselves on the basis of the information they provide to the benefit of investors.

Our securities markets have never been more competitive. With the spreading of liquidity across six times as many price points and the disclosure of execution quality, markets are altering the way in which they conduct their business in an effort to enhance their competitive position, in no small measure by enhancing their value proposition through data offerings. This is already evident from several ECNs displaying their limit order books, as well as the data offerings that the NYSE and other markets are delivering in the next few months or have announced.

ITEM II. CONSOLIDATION

Agenda Item II presents two primary alternatives:

- Preserving the current model's joint pricing, joint contracts and revenue sharing, as well as its joint systems (and mandating competitive bidding of the consolidation function), and
- Preserving the exclusive consolidation (systems) function (subject to mandatory competitive bidding), leaving SROs free to separately price and contract with respect to market data.

Agenda Item II also presents the possibilities of:

- Imposing the dissemination obligation on ECNs and other broker-dealers either in addition to, or in place of, SROs, and
- Allowing SROs to make available their information separately so long as they also make it available in consolidated form.

Consortia

As the next best alternative to permitting a SRO to withdraw from the consortia altogether (foreclosed in this exercise, but not in reality), we recommend permitting a SRO to establish data prices separately and enter into contracts separately, and thereby exit from revenue sharing. In these respects, our comments in our December 1 letter on the competing consolidators model apply. In effect, the sole remaining joint activity

would be in regard to systems, as is the case with ITS. Each SRO would pay its allocated share of the costs of operating the consolidation and data feed system.¹

Competitive Bidding

In contrast to the OTC/UTP Plan, the CTA and CQ Plans currently permit the SROs to subject the exclusive consolidator function to competitive bidding.² We would leave the decision whether to use competitive bidding in any particular two-year review cycle to the consortia's SROs.

We understand that the OTC/UTP Plan SROs are seeking to achieve separation of NASDAQ's intra-market facilities from its inter-market facilities by selecting a new exclusive processor that is systemically independent from NASDAQ. While competitive bidding runs a poor second to competing consolidators, within the constraints of this exercise, we believe that a competitive bidding process should be used in the initial selection. Provisions for periodic review comparable to those of the CTA and CQ Plans should also be included in the OTC/UTP Plan.

ECNs and Broker-Dealers

The SEC's authority to permit or require joint action on national market system matters is limited to SROs. Thus, in the absence of a membership relationship, there is no statutory basis, and hence no antitrust protection, for a SRO to engage with broker-dealers in a market data consortium engaged in activities that inherently entail the creation of burdens on competition. For this and the regulatory reasons that we have made clear in past submissions to the SEC³, we cannot participate in a consolidation consortium that includes ECNs and other broker-dealers.

¹ We note, however, that non-trivial issues regarding accountability for overall capacity planning failures (such as we have seen at NASDAQ and among the options SROs and options data vendors) are exacerbated when multilateral SRO/processor communication is foreclosed and consortium SROs with short-term financial incentives to lowball their estimates (whether via reduced revenue sharing or direct processor charges) provide capacity estimates to an exclusive processor.

² Under the CTA and CQ Plans, the SROs may review the processor at any time upon request by two SROs, and the plans mandate a biannual review. By majority vote, the SROs can replace the processor "for cause" at any time. ("Cause" includes degradation in either cost-effectiveness or quality.) With unanimity, the SROs can replace the processor without cause. The two plans are silent about how the SROs are to conduct a review or choose a replacement, but they are completely consistent with the SROs, by majority vote, determining to use competitive bidding for either purpose.

³ See, e.g., NYSE's "Comments on Electronic Communication Systems and the Trade-Through Disclosure Rule (Release No. 34-43084; File No. S7-16-00)" (October 17, 2000) at pp. 4-5; NYSE's "Response to Securities and Exchange Commission Concept Release on Market Fragmentation (Release No. 34-42450; File No. SR-NYSE-99-48)" (May 31, 2000) at n. 28; and NYSE's "Response to Securities and Exchange Commission Concept Release on 'Regulation of Market Information Fees and Revenues' (Release No. 34-42208; File No. S7-28-99)" (April 10, 2000; the "NYSE Response to the SEC's Market Data Concept Release") at pp. 2-3 of the memorandum included in Exhibit B thereto.

That said, our members are obliged under Rules 60 and 128A to honor quotes made on the NYSE and to report trades executed on the NYSE to the NYSE. Apart from being intrinsic to the auction process, their compliance enables the NYSE to meet its obligations under SEC Rules 11Ac1-1 (the firm quote rule) and 11Aa3-1 (the transaction reporting rule). So long as they meet those obligations, we have no view as to permitting ECNs and broker-dealers to make available market data outside the continuing consortium postulated by this agenda item. However, any continuing consortium requirements applicable to SROs must also apply to ECNs and other broker-dealers acting through their SROs. Also as a matter of fair regulation, if the display rule is amended to permit broker-dealers and vendors to separately display the market data of a single ECN or other broker-dealer, then the rule should be concomitantly amended to permit broker-dealers and vendors to display the data of a single SRO.

Individual SRO Dissemination in Addition to Consolidated Dissemination

We cannot imagine any justification for precluding a SRO from making its own data available separately so long as it has enabled brokers and vendors to comply with the display rule as it may be amended.

ITEMS III & IV. GOVERNANCE AND SEC RATE REGULATION

Agenda Item III proposes alternatives for retaining or changing the current governance of the consortia with respect to (1) composition, (2) voting requirements and (3) admitting new entrants. Item IV looks at the same issue from the perspective of establishing fees and sharing revenues, raising the possibility of limiting fees to recovery of specified costs and allocating revenue sharing to fund “certain SRO functions”. Item IV also suggests that each SRO might be permitted to separately sell its data to “the exclusive processor” on a wholesale basis.

Preliminary Matters

We note that:

- Conclusions as to Agenda Items I and II can have significant consequences for some of the issues discussed in Items III and IV, including the potential for reducing their importance or mooting them altogether.
- The history, structure, corporate form and governance of CTA and the NYSE differ significantly and relevantly from those of the OTC/UTP dissemination and NASD/NASDAQ.⁴ Thus, solutions that may be necessary or appropriate with regard to the current OCT/UTP Plan, the NASD/NASDR and the separated and demutualized NASDAQ may be inappropriate or counterproductive as applied to the CTA and the NYSE.
- The agenda is incorrect in describing the CTA “operating committee” as subject to a requirement for unanimity as to matters that the SROs have delegated to it. The unanimity requirement applies solely to fee changes and other plan amendments that the SROs have reserved to themselves for direct action. Unanimity is almost invariably a requirement for amending joint venture agreements. In the context of a venture among self-regulating entities, it assures that users decisions made at the SRO level are not frustrated at the joint venture level. As an additional safeguard, the SEC has the authority to override a SRO’s veto, an obligation and responsibility that it has appropriately exercised with great restraint.
- Because the SROs have reserved for their direct action fee changes and other plan amendments, the agenda’s characterization that the user constituents have only “*some* degree of *indirect* influence” over CTA actions is incorrect (emphasis added). Their influence is as pervasive and direct as to CTA matters as it is to any other SRO matter. Under the New York Not-for-Profit Corporation Law, all matters not reserved to its members repose in its constituent Board, subject to such delegation as it sees fit to exercise. The national market system plans are an unusual means by

⁴ As we described in some detail in my letter of October 17, 2000 letter to Richard G. Ketchum, President and Chief Operating Officer, NASDAQ Stock Market (which we have previously made available to Committee members), the significant differences of the CTA/CQ Plans from the OTC/UTP Plan include a more limited role for the OTC/UTP Plan’s Operating Committee -- and a concomitantly greater role for NASDAQ and the OTC/UTP Plan processor -- in fee, contract and administrative matters. This greater level of NASDAQ control is bolstered by a more expansive list of matters that NASDAQ (or any regional exchange) can veto. NASDAQ also has the unilateral right to extend hours, and enjoys preferential and confidential treatment regarding links to non-U.S. exchanges. We also understand that the OTC/UTP Plan processor does not report developments to the Operating Committee either orally or in writing and, indeed, that the Operating Committee had never met until recently.

As matter of corporate structure, NASDAQ is now organized as a business corporation. We understand that, following its registration as a national securities exchange, the NASD will lose voting control over NASDAQ and that NASDAQ continues to seek to conduct an IPO. The NYSE has no plans either to separate its Regulatory Group or to change its organization as a membership co-operative precluded from distributing profits to its members by the New York Not-for-Profit Corporation Law.

which the Board delegates its authority: more typical are the NYSE rules, other internal charters and continuing documents, and resolutions related to specific actions or projects.

Supra-SRO Governance, Direct SEC Rate Regulation and Funding Allocation

The agenda's focus on the ministerial operating committees is misplaced, and becomes a pretext for supra-SRO and SEC intervention that, as we described in our response to the SEC Market Data Concept Release, is inefficient and counterproductive. We think SEC Chairman and Supreme Court Justice Douglas had it right 61 years ago when he described the genius of broker-dealers self-regulation under SEC oversight:

[We let] the exchanges take the leadership with Government playing a residual role. Government would keep the shotgun, so to speak, behind the door, loaded, well-oiled, cleaned, and ready for use but with a hope it would never have to be used.⁵

While we are no match for Justice Douglas's eloquence, we tried to succinctly capture the checks and balances created by user allocation of NYSE costs in my brief letter of February 8 to Committee Members (attached for your convenience as **Appendix B**).

- Our February 8 letter first observes how our history of declining market data costs, and of a stable percentage contribution of market data fees, belies any exercise of market power by NYSE, whether part of or separate from CTA. We posited that the reason for this history is that the NYSE does not so much establish prices as allocate costs.⁶ Constituent representatives⁷ act by consensus to establish NYSE prices by first determining the NYSE's funding needs, and then allocating the resulting costs among themselves. We pointed out that, whenever the users of NYSE services change the allocation, the change must withstand scrutiny by constituent proxies -- Board representatives of potential "winners" and "losers" in the reallocation -- as well as by the Directors

⁵ W. O. Douglas, *Democracy and Finance* (Allen, ed. 1940) 82.

⁶ See also NYSE Response to the SEC's Market Data Concept Release at pp. 2-3.

⁷ The Exchange first added "Public Directors" to its Board in 1938. Effecting the recommendations of the 1971 report of William McChesney Martin, Jr., the Exchange reorganized its Board into one balanced along constituent lines in 1972, splitting non-management directors 50/50 between "Industry Directors" and "Public Directors". Congress subsequently mandated constituent representation -- as well as its implicit corollary, the fair allocation of costs -- when it amended the 1934 Act in 1975. Section 6(b)(3) of the 1934 Act requires that an exchange's rules "assure fair representation of its members in the selection of directors and administration of its affairs." It also requires that "one or more directors shall be representative of issuers and investors and not be associated with a member, broker, or dealer." Section 6(b)(4) requires that "the rules of the exchange provide for the equitable allocation of reasonable dues, fees, and other charges among its members and issuers and other persons using its facilities." Contrast this governance model, which is more akin to that of a legislature, to the typical corporate board, where a significant majority of disinterested directors is held up as the model.

representing solely the public interest.⁸ We also described the process of “indirect negotiation” among users that the NYSE staff facilitates before a fee proposal ever reaches the NYSE Board.⁹

- The February 8 letter also observes that the SROs had never delegated fee or other key decisions to the SRO managers comprising the “operating committees” of the consortia.¹⁰ We also pointed out that economists would recognize as optimal and fair a mechanism by which the consumers of a complex, interdependent set of services determine what they pay.¹¹ We noted how that mechanism had allowed the SEC to confine itself to the role of assuring fair constituent representation and processes in SRO governance – leaving the role of fee regulator as one of last resort.¹² We closed by pointing out that moving to a competitive model would enhance, not relax, the discipline of constituent cost allocation on any latent market power.

We believe our February 8 letter and our response to the SEC’s Market Data Concept Release create a compelling case for leaving to our constituent Board the task of making funding decisions, allocating costs and denominating fees to effect that allocation. As we foreshadowed above in our discussion of preliminary matters, thoughtful people at the SROs and the SEC faced the identical set of issues in the mid-1970s and negotiated a governance mechanism that has served us well for more than 25 years. They have bequeathed to us a thoughtful system of checks and balances regarding CTA, including limited SRO delegation to the CTA operating committee, SRO veto of fee changes and other plan amendments, and the SEC’s ability to override SRO vetoes, that serves to transmit user self-determination at the SRO level to the consortium. If we were to preserve the consortia, we ought not lightly to tamper with those checks and balances.

For all these reasons, if the consortia do survive, we see no case for shifting the locus of decision making to the SRO consortia and for introducing representatives other than SRO delegates at the supra-SRO level.

⁸ For example, effective this year, the Exchange reassigned some costs to floor members that would otherwise have been borne by issuers and upstairs firms. This is just the most recent step in a process that began in 1978 to more specifically assign regulatory costs with separately-denominated regulatory fees assessed on members and member organizations. In another example, in 1999 we reallocated certain costs by cutting the per-quote market data fees and creating a broker-dealer enterprise cap.

⁹ See also NYSE Response to the SEC’s Market Data Concept Release, at pp.13-15; Appendix E to the NYSE Response at pp.2-3; and Letter dated October 13, 1999, from Thomas E. Haley, New York Stock Exchange, to Robert Colby, Deputy Director, Division of Market Regulation, Securities and Exchange Commission, at pp. 5-6.

¹⁰ Thus, as noted above, the oft-criticised unanimity requirement for major consortium issues serves to assure that the decision of the SRO users is not thwarted at the consortium level.

¹¹ See also NYSE Response to SEC Market Data Concept Release at pp. 13-15; Appendix C to the NYSE Response at pp. 1-4; Appendix C-2 to the NYSE Response at pp. 7, 9-14.

¹² Under 1934 Act section 19, the SEC only has the power to abrogate SRO fees, which are effective on filing. Focusing on the potential non-pricing restrictions resulting from the SROs acting jointly in a market data consortium, Congress gave the SEC broader authority under section 11A. See NYSE Response to SEC Market Data Concept Release at pp. 4-6; Appendix B to the NYSE Response at pp. 13-18.

However, we wish to point out some of the practical consequences of attempting to effect that shift. The shift would require replicating the SRO governance system at the supra-SRO level. Apart from the changes to the 1934 Act, SEC rules and the joint venture agreements that this would entail, we doubt that a supra-SRO governance organization devoted to the narrow task of market data administration could attract the caliber of senior executives and public servants that serve on our Board.¹³ Moreover, such a shift would attenuate the cost allocation decision for the third of the NYSE's four largest revenue sources¹⁴ from the Exchange's budgetary and funding decision. It would also bifurcate between two user governance structures the allocation among listing, transaction and regulatory fees on the one hand and market data fees on the other hand. As noted, the consortium structures' user representatives would likely be of lower seniority and reduced breadth of view, and would operate out of pace with our Board, making appropriate sequencing difficult. The NASD's well-intentioned experiment with three boards (NASD, NASDR and NASDAQ) gives just a hint of the inefficiencies this introduces, and that occurred in an environment of 100 percent affiliation and a common chairman.

New Entrants

The CTA and CQ Plans have a provision that the SEC found in 1993 to "ensure that new market entrants are admitted to the plans on fair and reasonable terms". We believe that comparable provisions should be added to the OTC/UTP Plan.

Wholesaling to the Exclusive Processor

This proposal only makes sense in a competing consolidator model. Otherwise, the pricing of market data to end-users will have been moved from SROs (which is subject to constituent pricing determinations) to an entity that is subject neither to the existing discipline nor to the discipline of market forces. Thus, just as in the case of shifting the locus of decision making to the SRO consortia discussed above, this model would require the erection of new bureaucratic structures.

¹³ Of the NYSE's 24 non-management Directors, 11 are chief executive officers of member organizations and one is an individual member. The other 12 Directors are precluded from being affiliated with a member organization. In addition, at least one of these 12 must be associated with a listed company that is not a financial organization, and at least one other must be associated with a financial institution that is a significant investor in stocks. Our 12 Public Directors now include current or recently-retired CEOs of nine listed companies that are not financial institutions and three present or former public servants (one of whom is also a CEO of an institutional investor).

¹⁴ The other revenue sources, in order of the percentage of their contribution, are listing fees, transaction fees and regulatory fees.

ITEM V: ANCILLARY MATTERS.

Item V seeks discussion on three unrelated categories of issues: (1) administrative issues, (2) technological issues and (3) pilot programs.

Preliminary Matter

Administrative and technological issues are fairly technical. Information about the current practices and technology and their rationale are not widely understood. Moreover, these matters are relatively peripheral to the structural issues covered by Items I – IV. Thus, we agree with the suggestion in your January 18 e-mail that some or all of these items might best be left for a subsequent meeting. We also encourage you to consider using two separate subcommittees, each of which includes organization representatives with the requisite knowledge of existing procedures and practicalities pertaining to the subcommittee’s topic.

Administrative Issues

We remain committed to pursuing existing and appropriate new initiatives in this area.¹⁵

Technological Issues

The CTA and CQ systems, like NYSE systems, have no capacity constraints and we are unaware of any issues surrounding the accuracy and reliability of the data they produce. We are also unaware of any way in which they fall short on technologic innovation. The proposal to create an independent, competitively-bid exclusive processor function for the OTC/UTP Plan should place the dissemination of OTC/UTP stocks in a similar position.

Pilot Programs

The CTA pilot programs, which were effected pursuant to a SEC-approved provision of the CTA Plan, have served the industry well in responding to technological innovation given the cumbersome, multi-tiered approvals and reviews required for permanent plan amendments. We believe they should continue. We have no objection to appropriately changing those provisions so long as competitive initiatives do not have to be disclosed before introduction into the market place.¹⁶

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¹⁵ See NYSE Response to SEC Market Data Concept Release, Appendix E at pp. 10-11.

¹⁶ See also NYSE Response to SEC Market Data Concept Release, Appendix E at pp. 1-12.

I hope our responses prove helpful. We look forward to having an opportunity to discuss our responses and those of other members at the March 1 meeting.

Sincerely yours,

/s/ Robert G. Britz

Robert G. Britz

cc: Annette Nazareth
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Members of the SEC Advisory Committee on Market Information