

# Charles Schwab

MEMORANDUM

February 15, 2001

**TO:** Joel Seligman, Chairman SEC Advisory Committee on Market Information  
Annette Nazareth, Director SEC Division of Market Regulation  
Members, SEC Advisory Committee on Market Information

**FROM:** Carrie Dwyer  
Executive Vice President, Corporate Oversight  
Charles Schwab & Co., Inc.

**RE:** **Market Data Reform: A Response to Agenda Items for March 1 Meeting**

## Introduction and Guiding Principles

As we discussed at our last meeting, we do not believe that it is realistic or possible to separate discussions about how to improve the existing model for consolidating and disseminating market information from discussions and ideas about “alternative” market data models. Accordingly, our response to the agenda items necessarily reflects our views and analysis of both.

Any plan for reform must have at its core the following three principles:

### **1. Reform Must Promote Competition and Innovation.**

- Competition at all levels of the market data system will foster innovation to take advantage of electronic technologies. This will lead to the creation of market data products that better reflect today’s market behavior and will better serve all investors.

### **2. Open Access to, and No Ownership of, Quote and Last Sale Information.**

- No one has intellectual property rights to bids, offers, limit order prices, or last sale prices. These are essential market facts that must be readily available to all on equal, non-discriminatory, and publicly available terms.

### **3. Market Data Vending Must Be Separated from Self-Regulatory Functions.**

- To prevent conflicts of interest and the use of basic market data to advance anti-competitive ends, clear lines must be drawn between market data collection and vending. Accordingly, market data reporting, collection, and other activities involving SROs and their members that is required by regulation or SRO rule must be subject to SRO independent board control. All other market data activities – including consolidation -- must be separated from the self-regulatory function.

## Views on Enumerated Agenda Items

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## I. Market Information that Vendors and Broker-Dealers Should Be Required To Provide to Customers

- Retention of the current Display Rule requirement of Consolidated data is acceptable, provided that:
  - (a) Consolidation is based on a competitive model where each market center makes its data stream containing its best bids and offers with size and last sale reports (the “Mandatory Minimum”) available to any person or entity on a non-discriminatory basis.
  - (b) Consolidation is no longer controlled by the SROs through their joint plans.
- Provision of market information beyond the Mandatory Minimum should remain free from any regulation.

*Rationale:* The current requirements to display the consolidated NBBO with last sale information can serve several functional base-line purposes such as providing one benchmark for order execution, a readily available and recent snapshot of a security’s price, and a means to allow investors to value their portfolios. The SEC, in its regulatory discretion, reasonably may determine to continue the consolidated display requirement. If consolidated display remains a regulatory requirement, however, consolidation must be removed from the SROs’ monopoly control, as described below under Item II.

Beyond the NBBO and last sale data, there should be no display requirements, and market forces should be left alone to encourage the development and licensing of richer, more sophisticated real-time market data products. Vendors and broker-dealers should be free to produce, purchase, and display whatever additional market data elements they wish. Independent market data subsidiaries or affiliates of SROs should be allowed to compete with market data vendors free from regulation.

## II. How Market Information Should Be Consolidated

- Joint SRO plans should be dissolved. Individual SRO transaction reporting plans would focus on how an SRO collects and aggregates the Mandatory Minimum from its members and how the SRO complies with two requirements:
  - (a) Non-Discrimination. SROs must make their individual Mandatory Minimum data streams available to any person or entity who wants it on a “most favored nations” and enterprise fee basis, without regard to the buyer’s business model and without restrictions on redistribution channels.
  - (b) “Sunshine.” An SRO must make its fee schedule and general contract terms publicly available. One or more private entities (e.g., the Software Information Industry Association’s FISD) could be designated as a repository for the sunshine information.
- Any entity may act as a Consolidator of either or both exchange-listed and OTC Mandatory Minimum. For example, Nasdaq and SIAC could compete with each other and market data vendors to sell both exchange-listed and OTC Consolidated Mandatory Minimum.

*Rationale:* Competition in consolidation is a fundamental building block of any market data reform. Although the joint plans may have made sense in light of the limited technology that was available twenty-five years ago, the joint plans today serve no purpose except to perpetuate the SROs’ monopoly control over data required to be displayed by everyone under mandatory regulations.

Any person or entity should be allowed to consolidate. To open consolidation to competition, the SROs must make their individual data streams available to all on an equal basis. Multiple, competing consolidators will assure redundancy and improved consolidation capacity across the market. Although we believe that a cost-based approach to making regulatory-required data would be inherently fair – given that all market participants contribute to its reporting and collection and therefore its value – we understand the SEC’s reluctance to engage in “rate-making.” On the other hand, the current system of deference to SRO market data fee changes that become effective upon filing is detrimental.

As a substitute for directly regulating the amount of fees, we propose enforcement of two principles: non-discrimination and sunshine, as summarized above. Because everyone gets the same best deal that any one else can get, this will assure that market data vendors and broker-dealers without political clout will not be disadvantaged. The non-discrimination and sunshine requirements would also prohibit so-called “pilot programs” that have long given rise concerns about abuse and “sweetheart” deals.

Moreover, the non-discrimination and sunshine requirements would greatly simplify the administration of the market data system. No ongoing reporting to the SRO Plans or “Exhibit As” would be required or allowed, as fees would be enterprise-based without any limitations on distribution channels. This would result in a tremendous cost and time savings for the exchanges, vendors, and broker-dealers. It would also eliminate the competitive disadvantage of having to receive pre-clearance of market data innovations from the SRO Plans.

### III. Governance of the Consolidators

- As stated above, the SRO Plans should be abolished, eliminating the bureaucratic and administrative problems with their governance.
- If SROs choose to be in the business of consolidation, the consolidator must be in a subsidiary or affiliate separate and independent from all self-regulatory arms of the SRO. A SRO’s transaction reporting plan, as described above, including making its Mandatory Minimum data stream available to all, must be under the direction of the SRO board with public representatives. The SRO boards would be charged with enforcing the Non-Discrimination and Sunshine requirements.

*Rationale:* The focus of reform should be on promoting competition and innovation to serve better our markets and investors. Time should not be spent tinkering at the margins with antiquated institutions ill-equipped to deal with twenty-first century challenges. If SROs choose to compete as consolidators or as more sophisticated market data product vendors, such market data activities should be kept separate from all self-regulatory functions. This is consistent with the evolution of our markets to profit-making, competitive enterprises and the need to assure independent, fair, and focused self-regulatory bodies.

### IV. How User Fees Are Determined and Revenues Allocated Among Plan Participants

- The agenda is simply inaccurate where it states that “user fees charged by each SRO Plan for its market information typically are negotiated with vendors, broker-dealers, and other users.” There is no real negotiation today, except “take it or leave it.”

- As explained above, the SRO obligation to collect and aggregate the Mandatory Minimum information from its members must be unbundled from distribution of the Consolidated Mandatory Minimum from all SROs. There should be no “user fees” for the SRO data – just a single enterprise fee based on the Non-Discrimination and Sunshine requirements noted above.
- Provided that there is more than one consolidator of both exchange-listed and OTC securities and anti-trust laws apply, the charges for the Consolidated Mandatory Minimum should be wholly subject to market forces. Until there is more than one consolidator, fees for the Consolidated Mandatory Minimum would be subject to the Non-Discrimination and Sunshine requirements.
- Because the SRO Plans would be abolished, gone too would be the question of how the SROs should divide and allocate the Plans’ monopoly profits. The SROs, of course, may still earn revenues from market data.

V. Ancillary Matters

We believe this adequately addresses the issues of administration, technology, and pilot programs that are noted under this agenda item.