

**A PROGRESS REPORT ON THE  
SECURITIES AND EXCHANGE COMMISSION  
ADVISORY COMMITTEE ON  
MARKET INFORMATION**

**FOR DELIVERY FEBRUARY 1, 2001  
SIA MARKET DATA CONFERENCE  
New York Marriott Marquis**

**Remarks by Joel Seligman  
Chair, SEC Advisory Committee on Market Information**

In September 2000, the Securities and Exchange Commission created an Advisory Committee on Market Information to assist the Commission in evaluating issues relating to the public availability of market information in the equities and options markets. Specifically the Committee was asked to address: (1) The value of transparency to the securities markets; (2) the ramifications of electronic quote generation and decimalization for market transparency; (3) the merits of providing consolidated market information to intermediaries and customers; (4) alternative models for consolidating and disseminating information for multiple markets; (5) how market information fees should be determined, including the role of public disclosure of market information costs, fees, revenues, and other matters and how the fairness and reasonableness of fees should be evaluated; and (6) appropriate governance structures for joint market information plans, as well as issues related to plan administration and oversight.

A diverse and quite talented Committee of 25 individuals was appointed. Among others, the Committee includes representatives of the New York, Chicago, and American stock exchanges, the Chicago Board Options Exchange, the NASD, the Software and Information Industry

Association, Reuters, American Century, Morgan Stanley Dean Witter, Charles Schwab, Susquehanna, Salomon Smith Barney, First Union, Merrill Lynch, Fidelity, Bridge Trading, Datek, Knight/Trimark Group, Archipelago, the SIA, as well as public representatives from McKinsey & Company, MIT, and Georgetown University Law Center.

As an Advisory Committee we are not bound in our review of market information by existing rules or statutes, nor, as a practical matter are we limited by the inevitable institutional patterns and routines that evolve between a regulatory agency and those it regulates.

Our charter, however, is clear on two points. We are requested to deliver a written report to the full SEC no later than September 15, 2001. And this Report is limited to the topic of market information.

In 1975 when the Securities Acts Amendments were enacted, consolidated market information was viewed as a cornerstone of a National Market System. The National Market System also envisioned unfixed brokerage commission rates, effective market linkages, and vigorous price competition. Ultimately when we address market information, we address one aspect of whether this model of a National Market System should endure.

We were not asked to report on such topics as payment for order flow, ITS, or other market linkages. Our challenge is not to address whether the National Market System enacted by the 1975 amendments is wise or unwise, but whether the current system of disseminating market information in the equity and options markets should be endorsed, reformed, or replaced.

An inspiration for the Advisory Committee on Market Information was a June 1999 petition filed by Charles Schwab & Company urging the SEC to review the Consolidated Tape Association (CTA) market data fee structure imposed on broker-dealers, other market data vendors, and retail investors on grounds that it was unjustified, unreasonable and discriminatory.<sup>1</sup>

In December 1999 the Securities and Exchange Commission circulated a Concept Release placing the question of fees for market information in a broader context.<sup>2</sup>

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<sup>1</sup>Letter to U.S. Securities and Exchange Commission from Sam Scott Miller, Orrick, Herrington & Sutcliffe (June 29, 1999) (on behalf of Charles Schwab & Co.).{ADVANCE \d12}

<sup>2</sup>Sec. Ex. Act Rel. 42,208, 71 SEC Dock. 496 (1999).{ADVANCE

The Commission Release emphasized several points. It stated about the 1975 Act:

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Broad public access to consolidated market information was not the fortuitous result of private market forces, but of planning and concerted effort by the Congress, the Commission, the SROs, and the securities industry as a whole. Prior to the 1970's, the various SROs had acted individually in deciding who would be entitled to receive their market information and on what terms. In the early 1970's, the Commission took the initial steps toward creating a central market system in which investors would have access to information from all markets. Congress adopted this fundamental policy determination when it enacted the Securities Acts Amendments of 1975. . . . Using this authority, the Commission adopted a number of rules pursuant to which the SROs act jointly in disseminating market information. Under this regulatory framework, the SROs have developed and funded the systems that have been so successful in disseminating a highly-reliable, real-time stream of consolidated market information throughout the United States and the world.<sup>3</sup>

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<sup>3</sup>Id. at 498.{ADVANCE \d12}

Nonetheless, the economic context of market information has dramatically changed since the early 1970s. A[N]ew technology has greatly expanded the opportunity for retail investors to obtain access to real-time market information through >on-line= accounts with their broker-dealers.@<sup>4</sup>

The structure of securities industry itself is rapidly changing with the growth of Electronic Communications Networks (ECNs) or Alternative Trading Systems, some operated on a for-profit basis, and ongoing efforts of the exchanges and the NASD to evolve into for-profit corporations.<sup>5</sup> Market information may prove pivotal in these efforts. In 1998 market information revenues represented 21 percent or \$410.6 million of the SROs total revenues of \$1.97 billion.<sup>6</sup>

The Concept Release summarized the current institutional structure for disseminating market information:

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<sup>4</sup>Ibid.

<sup>5</sup>Id. at 499.{ADVANCE \d12}

<sup>6</sup>Ibid.{ADVANCE \d12}

The arrangements currently in place for disseminating market information are the product of a variety of different national market system plans that operate in accordance with a variety of different Exchange Act rules. The arrangements are most usefully organized, particularly from the standpoint of their fees, revenues, and expenses, according to the four networks or systems that the SROs have developed to disseminate market information for four different categories of securities: (1) Network A B securities listed on the NYSE; (2) Network B B securities listed on Amex or the regional exchanges; (3) Nasdaq System B securities qualified for inclusion in the Nasdaq Stock market, Inc. (ANasdaq@) and certain other securities traded in the over-the-counter (AOTC@) market; and (4) OPRA System B exchange-listed options. . . .

Of greatest consequence to the Advisory Committee were the policy questions articulated by the Commission's Concept Release. These include:

- Is the current governance structure of the CTA Plan, CQ Plan, Nasdaq/UTP Plan and OPRA Plan appropriate?<sup>7</sup>
- Are current vendor and subscriber fee structures appropriate?<sup>8</sup>
- Is it appropriate that the CTA, CQ, and NASD rules to authorize pilot programs that are not filed for Commission review and have been used for sustained periods?<sup>9</sup>
- Should the Commission adopt a cost-of-service approach to its review of market information fees?<sup>10</sup>

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<sup>7</sup>Id. at 502.{ADVANCE \d12}

<sup>8</sup>Id. at 503-504.{ADVANCE \d12}

<sup>9</sup>Id. at 504.{ADVANCE \d12}

<sup>10</sup>Id. at 505. Cf. id. at 509-512, including discussion of NASD v. SEC, 801 F.2d 1415 (D.C. Cir. 1986). Much of the Concept Release focused on SRO financial structures and how a cost of service approach might be structured. See id. at 512-525.{ADVANCE \d12}

- Should audited financial statements be filed with the Commission and be publicly available?<sup>11</sup>

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<sup>11</sup>Id. at 526.{ADVANCE \d12}

- Should securities industry or public participation be added to the Plans= governance?<sup>12</sup>
- Should the administration of fee structures be made more efficient and streamlined through revision of agreements, policies and reporting requirements that apply to vendors, broker-dealers, and subscribers?<sup>13</sup>

Against this backdrop the Advisory Committee was challenged to evaluate what would be the best approach for the dissemination of market information in the foreseeable future.

The Committee has now met on two occasions. It is not too early to predict that the potential outcome of our deliberations will be bimodal.

The Advisory Committee will analyze whether new systems for dissemination of market information can be articulated that would succeed the current arrangements through the CT, CQ, Nasdaq/UTP and OPRA Networks. Focusing solely on equities the Committee to date has received

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<sup>12</sup>Ibid.{ADVANCE \d12}

<sup>13</sup>Id. at 526-527.{ADVANCE \d12}

five proposals for alternative models for the dissemination of market information. Each, to varying degrees, suggests a more free market approach to the oversight of the dissemination of market information.

Acting under the Charter which created the Committee, I have communicated to the Committee my intention to form a Subcommittee, to be chaired by Georgetown University Law Professor Donald Langevoort, one of our public members, to analyze how a new system for disseminating market information would operate. This analysis would include consideration of:

- What would be the technological parameters of a system with multiple information consolidators?
- Who would be consolidators?
- What would be the benefits of such a new system?
- What would be the costs and risks involved, particularly focusing on such questions as market transparency and the best execution obligations of broker-dealers?

In considering the creation of new means of disseminating market information, we are all alert to the reality that the same system may not be equally appropriate for the equity markets as it is to the options markets.

Alternatively, the Advisory Committee will analyze how if the CT, CQ, Nasdaq/UTP, and OPRA Systems are retained they might be improved. On March 1 the Committee will hold its next meeting. I recently circulated a detailed agenda for us to consider. We will focus on four fundamental questions.

First, what market information should vendors and broker-dealers be required to provide to customers? Under the current display rule, Rule 11Ac1-2, a vendor or broker-dealer that provides market information to customers must include, at a minimum, a consolidated quotation display and consolidated last sale display. If quotation information is provided with respect to a particular security, the vendor or broker-dealer must include either the NBBO (the best bid and best offer, with size, from any reporting market center, and an identification of the applicable market center), or a quotation montage for the security from all reporting market centers. If transaction reports or last sale data are provided with respect to a particular

reported security, the vendor or broker-dealer must include the price and volume of the most recent reported transaction, and an identification of the market center in which each transaction took place.

On March 1, the Advisory Committee will consider alternative approaches to a mandatory information requirement, specifically including:

- Retention of the current Display Rule requirements.
- Increasing or reducing the minimum information that must be provided to customers under the Display Rule. This issue has taken on greater significance because of decimalization.
- Eliminating the Display Rule, and relying solely on broker-dealers' best execution obligations and customer demand to determine the appropriate level of market information.
- With respect to the provision of market information beyond a mandatory minimum, we could recommend that it should be left free from regulation or that additional information should be provided in a consolidated format.

Analysis of this issue may ultimately have significance both for alternative means of disseminating market information and for potential improvement of current systems.

Second, the Advisory Committee will consider how market information should be consolidated. Under the Transaction Reporting Rule 11Aa3-1, each exchange is required to file with the Commission a plan for the dissemination of transaction information for listed equity and Nasdaq securities traded through its facilities, and the NASD is required to file a plan for the dissemination of transaction information for securities executed by its members otherwise than on an exchange. These plans address, among other things, the consolidation of information. In addition, every broker-dealer is required to transmit to any exchange of which it is a member or the NASD all information required by that SRO's transaction reporting plan.

Under the Quote Rule 11Ac1-1, each exchange is required to collect, process, and make available to vendors the best bid, the best offer, and aggregate quotation sizes for each subject security listed or admitted to unlisted trading privileges that is communicated on that exchange. The NASD is required to collect, process, and make available to vendors the best

bid, the best offer, and aggregate quotation sizes for each subject security communicated by an OTC marketmaker, as well as the identity of that marketmaker. In addition, every broker-dealer is required to promptly communicate to the applicable exchange or the NASD its best bids, best offers, and quotation sizes for each subject security.

The SROs have fulfilled their obligations under the Transaction Reporting Rule and Quote Rule by implementing the CTA, CQ, and Nasdaq/UTP Plans. Under these Plans, Plan processors such as SIAC and Nasdaq, collect transaction and quotation information from each SRO Plan participant, and then consolidate and disseminate that information to vendors and broker-dealers.

On March 1, the Advisory Committee will analyze whether:

- We should retain the current model with SIAC and Nasdaq acting as consolidators of market information under joint SRO Plans.

- We should retain the existing joint SRO Plans, but make the exclusive consolidation function subject to active competitive bidding at the end of each contract term.
- We should dissolve the joint SRO Plans and have each exchange and the NASD file a separate transaction reporting plan, but retain an exclusive consolidator of market information that would be selected through competitive bidding.
- We should place the obligation to provide market information to the exclusive consolidator on entities other than, or in addition to, the SROs such as marketmakers or ECNs.
- We should allow markets to make available their information separately, subject to minimum mandatory consolidation requirements.

In our discussions to date, the issue of how market information should be consolidated has received the greatest attention. It is precisely because

there are disparate views that I asked Professor Langevoort to chair a Subcommittee to be sure we analyze all serious possibilities. Professor Langevoort's task will, in essence, focus on whether we should recommend multiple competing consolidators in a less regulated environment.

In an address at Stanford University on January 8, 2001, Chairman Arthur Levitt stated in part:

There is no avoiding, however, a fundamental dilemma: allowing unfettered market forces to dictate the cost of pricing data is in direct tension with the mandate for market transparency. Put another way, if market forces allow a dominant market to name the price for its data, this also means the market can withhold the data if it does not get its price. Suffice to say, the implications are not only in conflict with Congress' mandate, but wholly unacceptable for America's investors. Too many investors would be forced to price orders in the dark. The current pricing standard – the NBBO, or national best bid and offer –

could be supplanted by scattered patches of varying prices, visible to only a few.

Could today's communications revolution reunite these patches into a national pricing mechanism? Certainly. But the real issue is whether individual competitive interests would ultimately lead back to full transparency. In the meantime, the uncertain outcome and threat to public confidence might very well take their toll.<sup>14</sup>

The Committee is not bound by Chairman Levitt's view, as he himself has emphasized, but we are alive to the challenge his words suggest.

Whether we attempt to improve an existing consolidation system or replace it, we deal with systems that may be technologically outdated; not well structured to fully integrate ECNs and other new trading mechanisms; not well structured to integrate modern information technology or the full range of information vendors.

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<sup>14</sup>Remarks by Chairman Arthur Levitt, The National Market System: A Vision that Endures (Stanford University, Palo Alto, California, Jan. 8, 2001).

At the same time, the risk to investors of replacing a system that long has operated successfully and still works reasonably well with a more free market alternative that may be less transparent is a real one that the Committee and the new Subcommittee will analyze seriously.

Third, the Advisory Committee will also analyze the governance of the consolidators. Each of the existing joint SRO Plans is governed by an Operating Committee composed of one representative from each SRO participant. In general, a majority vote of the Operating Committee is sufficient to approve actions in accordance with the existing Plans, and a two-thirds vote is needed to adopt fee increases or new fees. Amendments to the Plans and other significant actions, however, generally require a unanimous vote of the Operating Committee.

Governance has been an issue with some controversy. Chairman Levitt, in his January 8, 2001 speech stated:

The decision making process of those markets that collect and distribute the data should indeed, in my view, be more open and transparent. Alternative markets, broker-dealers and

consumers should have meaningful input in critical decisions.

And the ability of one market to veto decisions that bear directly on the public interest – such as how much to charge for data, and whether to upgrade the technology for disseminating it – should certainly be a thing of the past.<sup>15</sup>

Again, the Advisory Committee is not bound by the Chairman's point of view, but will take it into account.

From the perspective of at least one exchange, the critical issue is not the membership and voting rules of the CT and CQ Plans, but the membership and voting rules of the Exchange itself, which are more diverse and not subject to the unanimity requirement.

On March 1, the Advisory Committee will analyze whether:

- We should recommend the existing composition and voting requirements of the Operating Committees be retained.

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<sup>15</sup>Remarks by Chairman Arthur Levitt, The National Market System: A Vision that Endures (Stanford University, Palo Alto, California, Jan. 8, 2001).

- We should recommend that the composition of the Operating Committees, or other Plan committees, be broadened to include representatives of other constituencies such as vendors, broker-dealers, and public investors.
- We should recommend that the voting requirements of the Operating Committees be modified, for example, to permit Plans to be amended with a majority or two-thirds vote.
- We should recommend that new market entrants be admitted to the Plans for membership.

Fourth, the Advisory Committee will also consider how user fees are determined and revenues allocated among plan participants.

The Exchange Act grants rulemaking authority to the SEC to assure that Securities Information Processors (SIPs) may obtain market information from an exclusive processor of that information on terms that are “fair and reasonable”, and all persons may obtain market information on terms that are “not unreasonably discriminatory”.

The user fees charged by each SRO Plan for its market information typically are negotiated with vendors, broker-dealers, and other users. Because these fees must be filed with the SEC as proposed rule changes, and are subject to public notice and comment procedures, interested parties may submit their views on proposed fees directly to the SEC if negotiations have not led to a mutually satisfactory result.

Under the CTA and CQ Plans, after payment of operating expenses, fee revenues are distributed among the SRO participants in accordance with their proportional share of total transaction volume. Under the Nasdaq/UTP Plan, after payment of operating expenses, revenues are distributed among the SRO participants based on an average of the percentage of total transaction volume and the percentage of total share volume, subject to specified floors and caps.

In this area the Committee will analyze only market information that is required to be provided to customers. Fees and revenue allocations for information beyond the mandatory minimum will be determined by market forces, which may or may not be subject to backstop SEC oversight.

The issue of how fee levels to customers are determined was the initial precipitant of the SEC Concept Release in December, 1999.

On March 1, the Advisory Committee will consider:

- A recommendation that the existing mechanism for determining user fees and allocating revenues among the SRO participants be retained without change. For example, if participation in Plan governance is broadened, the Committee could recommend primary reliance on the governance process to set fees and allocate revenues, with backstop SEC oversight. This would essentially involve no change in the way the SEC reviews fees.
- Alternatively, the Advisory Committee could recommend a more precise standard for evaluating the fairness and reasonableness of fees, such as a cost-based limit with specifications of appropriate costs, and for distributing market information revenues, such as to fund more fully certain SRO functions.

- Or, the Committee could recommend that each entity providing information to the central processor be permitted to negotiate fees for its market information directly and separately with the exclusive consolidator, subject only to backstop SEC oversight.

Underlying any analysis of the SEC's role in setting fees is the collective memory of a similar Commission role with respect to fixed brokerage commission rates before 1975. This was not a happy history for the Commission. By the early 1970s, Commission fee review was, in essence, criticized for taking too long, being too insensitive to evolving market developments, and being too unsophisticated in its economic analysis.

The Commission historically has not sought a role as a fee regulator. It is a role in the market information area that it has largely tried to avoid through governance mechanisms. One advantage of a free market approach to the dissemination of market information would be to avoid the SEC's role as a fee regulator.

On the other hand, the costs and risks of reducing or removing the SEC from oversight may ultimately persuade a significant proportion of the Advisory Committee of the necessity of a more active Commission role in evaluating market information fees.

This agenda for March 1 will address what are the most controverted issues in the comment letters received after the SEC's December, 1999 Concept Release and in our discussion to date. To be sure, there are serious ancillary issues that will also ultimately have to be addressed in the Advisory Committee's analysis of reforming the existing Plans. These include such administrative issues as ways that might be proposed to improve the operating efficiency of the joint SRO Plans, for example by standardizing and streamlining the agreements, policies, billing procedures, and reporting requirements that the various Plans currently employ. There are serious technological issues with respect to the operation of the market information dissemination plans. At the moment, these are most acute with respect to OPRA and capacity issues in the options markets. And concerns have been expressed about pilot programs provisions to implement fee structures for

periods of time beyond that which the provisions, some would argue, were intended to cover.

Our time for analysis is limited and should be. One exchange has already voted to initiate withdrawal from the CT and CQ Plans. This will not occur, I believe, without SEC review. Other participants have highlighted that new rules facilitating dissemination of new types of market information could have significant consequences to broker-dealers, information vendors, and investors.

When I agreed to chair the Advisory Committee, Arthur Levitt suggested to me that the work of the Advisory Committee should prove as easy as a Department of Defense Base Closing Committee or reforming Medicare. Any serious analysis of the issues involved should recognize that there are no quick and easy fixes here. From any interested point of view, solutions can be proposed that further the best interest of a particular exchange, a particular broker-dealer, or a particular information vendor. But the challenge for the Advisory Committee as a whole, like the challenge for the Commission which must ultimately review its recommendations, is to attempt to find a new approach to market information which balances the

needs of investors to make the most timely and inexpensive investment decisions with the needs of the exchanges, the broker-dealers, and market vendors to be able to provide their services in the most efficient manner.