SHADOW FINANCIAL REGULATORY COMMITTEE

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Statement of the Shadow Financial Regulatory Committee on

Enhancing Competition in the Sale of Stock Market Data

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Under current SEC regulations, two regulatory consortia are authorized to set the prices for data (known as data fees) on trades and quotes on the New York Stock Exchange (NYSE), the American Stock and Options Exchange (AMEX) and Nasdaq. These consortia are made up of the principal national and regional exchanges registered with the Securities and Exchange Commission (SEC). Data fees received by the consortia are divided among the exchanges on which transactions occur in proportion to the trading that occurs on each exchange. Thus, for example, if 5 percent of the trading in NYSE-listed securities occurs on the Pacific Coast Exchange, that exchange would receive 5 percent of the aggregate amount of the data fees attributable to transactions in NYSE-listed securities. The data is purchase from the consortia by broker-dealers and wire services, and the costs are ultimately passed along to investors.

Market data fees are substantial. In 2004, the revenues for the two consortia were $434 million. The expenses of operating the plans were $40 million, resulting in net income of $393 million. The NYSE was allocated $141 million of this net income, which represents 13 percent of its adjusted total revenues. Nasdaq received $78 million, which is 16 percent of its adjusted total revenues. The Pacific Stock Exchange received the third largest allocation ($76 million), primarily from the high volume of trading brought to it by Archipelago.

The fact that the consortia are made up of exchanges that should be competing in the pricing of this data is troubling. It seems clear that the prices set by the consortia are excessive, since there is an extensive system of rebating, in which broker-dealers who place their trades on particular exchanges get rebates out of the data fees the exchanges earn from the reporting the trades. These rebates could create a competitive market, but the SEC, through informal "guidance" has limited the rebates to 50 percent of the data fees attributable to an individual broker's placements. The Shadow Financial Regulatory Committee believes that competition in setting market data fees would drive down the costs of this data and ultimately benefit investors.

In Regulation NMS, the SEC proposed three changes to the market data sale procedures. It changed the revenue allocation formula, imposed new rules about information collection, and directed the creation of advisory committees to the consortia. It considered but rejected the need for fundamental reform. In so doing, the SEC noted that the exchanges derive a significant portion of their revenue from market information fees, and expressed the concern that reduced fees might lessen the ability of exchanges to regulate themselves at "high standards of SRO [self regulatory organization] performance." The Committee challenges the SEC's assumption that market data fees must be kept high in order to subsidize the regulatory activities of exchanges. First, it is not clear that the NYSE, now that it has become a private corporation, will retain its regulatory functions. In addition, there is no direct relationship between the data fees and the costs of regulation. Regulatory costs should be transparent, and paid for explicitly, not out of a pot artificially and arbitrarily filled by SEC regulatory policies.

Since Regulation NMS has not yet gone into effect, the Committee recommends that the Regulation's treatment of market data fees be abandoned. Essentially, it is tinkering with a structure that should be completely taken down. Instead, the SEC should give serious consideration to creating a competitive market for the data on trades and quotes produced by the various securities exchanges. This would not only eliminate a monopolistic pricing system, but more importantly, provide substantial benefits to investors.