# Market Participants to Their Corners: Competing Views on Market Data Are on Full Display at the SEC's Market Data Roundtable

Authored by Susan Grafton, Elliott Curzon, Ari Abramovitz, Keunjung Cho, Vince Nguyen and Kimberly Thomasson

December 2018

Dechert LLP

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**December 2018 / Authored by Dechert's Financial Services Team**

The Securities and Exchange Commission has solicited the views of exchanges, broker-dealers and investors on a range of questions related to market data since at least 1999 when it published SEC Concept Release: Regulation of Market Information Fees and Revenues (Market Data Concept Release). The robust discussion at the SEC's October 25-26, 2018 Roundtable on Market Data and Market Access (Roundtable) made it clear that many of the issues raised in the Concept Release have not been resolved, and in some cases have been exacerbated by electronic trading and the adoption of Regulation NMS.

The SEC's Division of Trading and Markets hosted the Roundtable following April 2016 recommendations by the SEC's Equity Market Structure Advisory Committee (EMSAC) for a Framework for Potential Access Fee Pilot and the U.S. Treasury Department's October 2017 report on A Financial System That Creates Economic Opportunities: Capital Markets, which recommended (among other things) that the SEC, when approving rule changes of self-regulatory organizations (SROs) related to market data, "determine whether the fees charged by an exclusive processor for market information are 'fair and reasonable,' 'not unreasonably discriminatory,' and an 'equitable allocation' of reasonable fees among persons who use the data." Further, Treasury also recommended that the SEC consider amendments to Regulation NMS to permit competing market data consolidators to purchase exchanges' proprietary market data feeds (including last sale and depth of book), on a non-discriminatory basis, in order to provide faster and broader market data as a lower-cost alternative to exchanges' securities information processors (SIPs).

No specific rule amendments or proposals were discussed during the Roundtable. Rather, as described below, the panelists discussed a number of central themes and issues that are regularly raised with respect to market data fees and costs – most recently, in securities industry challenges to exchange market data fees.[1]

## Introductory Remarks

Brett Redfearn, Director of the SEC's Division of Trading and Markets, framed the goals of the Roundtable as examining the infrastructure for distributing market data, and considering whether the infrastructure fulfills the SEC's obligations under the 1934 Act to ensure that market data fees: are fair and reasonable and not unreasonably discriminatory; and do not impose an undue or inappropriate burden on competition. Mr. Redfearn noted the current two-tiered system of market data and access, and questioned whether advances in proprietary data offerings have resulted in a model that necessitates the need to purchase additional proprietary data and access products simply for core data.

1 *See* In the Matter of the Application of Securities Industry and Financial Markets Association, Exchange Act Release No. 84432 (Oct. 16. 2018; In the Matter of the Applications of the Securities Industry and Financial Markets Association and Bloomberg L.P., Exchange Act Release No. 84433 (Oct. 16. 2018).

SEC Chairman Jay Clayton and Commissioner Robert J. Jackson Jr. framed the market data issues as how to best serve Main Street investors. Commissioner Jackson also expressed interest in learning how much it costs to produce market data.

Commissioner Hester M. Peirce asked participants to take a step back and look more broadly at market structure. She cautioned that inserting the government into markets typically impedes the flow of information.

Commissioner Elad L. Roisman stated his hope of gaining a better understanding of the demand for public data versus various types of proprietary data, and identified areas where he believes the SEC needs more information before considering policymaking. He raised the possibility of revisiting the SEC's 2004 Concept Release Concerning Self-Regulation (which discussed the advent of "for-profit" exchanges) and the extent to which market participants that utilize exchange data are bearing the costs of premium data.

Commissioner Kara M. Stein, whose term expires this month, raised general market structure concerns and encouraged participants to consider simple but difficult questions, such as what systems might be developed in connection with best execution and who should pay for market data.

## Panel Summaries

### *Panel One: Overview of Current Landscape for Market Data Products and Market Access Services*

The initial panel discussed the evolution of market data products and market access services, as well as whether the evolution of SIPs and other exchange products and services have affected market participants' ability to obtain the information needed to trade effectively in today's equity markets. In particular, the panelists discussed: (i) whether fees for market data and access services are inflated, based on the exchanges' monopoly position and broker-dealers' regulatory need for the information; (ii) the impact on trading costs for investors; and (iii) deficiencies in the SIP data that exchanges are required to make available.

The panelists were from Virtu Financial, Cboe, NYSE, IEX, T. Rowe Price, the Committee on Capital Markets Regulation, and Nasdaq.

Discussion Summary:

Generally, the exchanges characterized the issue of fees for market data products and access services as one between Wall Street and the exchanges, whereas the other panelists viewed the issue as between Main Street and Wall Street. In particular:

- Cboe and NYSE noted the historically low trading costs for retail investors and the ability to look up a stock quote without charge on a smart phone.
- T. Rowe Price disagreed with this position, noting the steep rise in the cost of non-display data over recent years, and that such costs are baked into investors' commissions.
- IEX noted that three corporate parents own the 12 other U.S. equity exchanges, which arguably creates a monopoly and permits the exchanges to charge "egregious" product markups and consistent price hikes because brokers must connect directly to an exchange to meet their best execution obligations.

- Cboe, NYSE, and Nasdaq each stated that market participants have a commercial choice and not a regulatory obligation to purchase proprietary market data, although the other panelists disagreed, stating that they must purchase proprietary market data and access (versus SIP data) to meet their best execution obligations.
- NYSE stated that not all brokers subscribe to proprietary data feeds from each of the exchanges of which they are members and argued that there is a competitive landscape across the various exchanges.

Panelists discussed deficiencies in SIP data and made recommendations for improvements.

- Most agreed that SIP data is slower than proprietary data and stated that a broker-dealer or investment manager making machine-level trading decisions cannot use only a SIP.
- Virtu suggested making the SIP competitive, and observed that firms receiving direct data feeds could homogenize a top-of-book feed and distribute it, thus providing better data at a fraction of the cost.
- Nasdaq suggested creating a better governance structure around the SIP, including permitting market participants to have a vote on the SIP Advisory Committee.

## *Panel Two: SIP Core Data Products and Exchange Top-Of-Book Data Products*

This panel focused on the extent to which SIP data products meet the needs of market participants in today's markets, including differences (such as latencies and data content) between SIP data products and exchange proprietary products. Panelists also discussed whether additional information, such as odd-lot data and depth-of-book information, should be included.

The panelists were from Nasdaq, TD Ameritrade, NYSE, Charles Schwab, Norges Bank Investment Management, Bank of America Merrill Lynch and Redline Trading Solutions.

<u>Discussion Summary</u>:

Panelists generally agreed that SIP data is a somewhat useful product.

- Schwab, however, strongly disagreed, noting that the quality of SIP data is poor and is essentially that same product that was designed in the 1980s. Schwab further noted that exchanges do not provide depth-of-book information due to concerns that it would lead to the cannibalization of exchanges' proprietary products, and argued that SIPs should be required to provide depth-of-book information.
- Other panelists contended that the SIP data is sufficient for retail investors, and that a requirement to provide a more sophisticated SIP data product would create unnecessarily higher costs for retail investors.
- The panel discussed some of the differences between the SIP data products and exchange proprietary products (such as latencies and data content), as well as the time delay of the SIP data feed, noting that some of the delay was attributable to the physical distance between the data processing centers in New Jersey through which data currently must pass.

Panelists generally agreed that odd lots should be added to SIP market data, but had different opinions regarding other potential additions, such as imbalances and depth-of-book.

- The exchanges argued that such features were their own proprietary intellectual property. They argued that if exchanges were required to share these products in the SIPs, this would eliminate incentives for exchanges to continue to develop new technology.

### *Panel Three: Exchange Depth-Of-Book Data Products and Market Access Services*

This panel focused on the exchanges' proprietary data products and market access services that offer the most content and the lowest latencies. The key themes discussed by the panelists were whether: (i) broker-dealers buy proprietary data products to gain a commercial advantage, or feel compelled to do to remain competitive; (ii) SIP data is a substitute for proprietary data products in certain business models, or simply has a supplemental role; (iii) the prices charged for proprietary data products are reasonable relative to the costs of creating them, and the role of transparency in determining this reasonableness; (iv) the alleged high costs of these products are a barrier to entry for smaller market entrants; and (v) exchanges should be treated as a regulated oligopoly with heightened responsibilities.

The panelists were from ICE, Trillium Management, Cboe, UBS, Citadel Securities, IEX and Clearpool Group.

<u>Discussion Summary</u>:

The non-exchange panelists criticized the exchanges for charging exorbitant prices that bear little relation to their true costs for proprietary data products. In their view, exchanges are able to do this because they are the sole source of this data and can exercise monopoly power to increase prices even though broker-dealers are required by competitive forces, and sometimes by law, to provide customers with best execution prices.

- Clearpool argued that the exchanges' complex tiered-pricing schemes provide an unfair advantage to larger, institutional players in the market, while serving as a significant barrier to entry for smaller firms. Clearpool further noted that large, institutional buyers of proprietary data products often receive rebates from the exchanges for providing liquidity, which are essentially subsidized by smaller players paying higher costs for these products.

ICE and Cboe stated that broker-dealers are not required by law to subscribe to exchanges' proprietary data products to carry out their best execution obligations, and do so only in furtherance of their business needs. They noted that not all broker-dealers and investment banks purchase proprietary data products, and many that do so choose not to purchase the most comprehensive products offered. Thus, broker-dealers have been and will continue to be able to customize their data purchases to their business models, proving that proprietary data is not a utility-like product that firms are compelled to buy.

- ICE and other exchanges also noted that they offer these products on equal terms to all subscribers, and that the revenues derived from this line of business constitute only a small fraction of the overall market. Additionally, Cboe, among other exchanges, noted that exchanges operate in a competitive environment, evidenced by the fact that price increases often lead to attritions in clients for the exchanges.

- The exchanges repeated earlier statements that trading costs for retail investors are minimal and have been decreasing for some time due to an increasingly efficient and transparent market. In their view, the argument over proprietary data pricing will likely only benefit large institutional investors.

## *Panel Four: Elements of the Core Data Infrastructure*

This panel focused on potential steps to modernize the infrastructure for providing SIP data and market access services, which market participants need to trade effectively in today's markets. Panelists discussed latency and data differentials between SIP data and proprietary data, as well as various models to address these concerns.

The panelists were from UC Berkeley, NYSE, AQR Capital Management, Hudson River Trading, Morgan Stanley, Nasdaq and PICO Quantitative Trading.

Discussion Summary:

Generally, there appeared to be a consensus that the current SIP definition and model are outdated and not useful for many market participants, and that improvements are warranted. However, disagreements remain as to: how expansive the new SIP definition should be; which constituency SIP data should serve; and how to create a SIP model that is flexible enough for future innovations.

There was also general acknowledgement among the panelists that there are appreciable latency and data differentials between SIP data and proprietary data.

- Latency differentials are caused by the geographic hops that SIP data must travel through during aggregation and dissemination, as well as differences in connectivity and bandwidth options.
- The content for each type of data also differs, with proprietary data containing more in-depth data (such as depth-of-book and order-by-order information) and SIP data containing regulatory and administrative messages not available in proprietary products.

The panel considered several alternative models for improving SIP data.

- *Distributed SIP Model*. NYSE advocated for a Distributed SIP Model, which it said would be the least costly and simplest approach for aggregating SIP data and potentially reducing latency issues significantly.

  Under this model, the existing SIP processors would set up "instances" of their systems in multiple data centers, and the exchanges would simultaneously broadcast their data to each "instance." Data recipients would consume data from one or more locations that they find most efficient, but market data would never travel more than one hop, as each instance would independently consolidate data. Data recipients would not be required to make any infrastructure changes, although those with latency concerns could choose to relocate their SIP data feed to the nearest instance.

- *Competing Market Data Aggregator (CMDA) Model*. Morgan Stanley expressed support for a CMDA model whereby the SIP Operating Committee would set up standards and allow consolidators meeting those standards to compete in producing SIP data, rather than having permanently appointed consolidators.

  The standards could include requirements such as requiring consolidators to be Regulation SCI–compliant and to produce SIP data of the same quality. Qualified consolidators would receive direct data feeds from the exchanges and be allowed to create and sell SIP data to subscribers for a fee. The advantages of this model would be to shift the burden of making technological choices away from the committee to the consolidators, and to allow competitive market forces to come into play.

- *One Feed One Speed Model*. Hudson River Trading and others expressed support for this model, which would create a system similar to CDMA, but apply the technological framework of proprietary data products to SIP data.

Other panelists raised concerns about several aspects of these models.

- Policymakers should not pick a particular technological model, since it will enshrine those technology and geographic locations that are competitive now, while not accounting for future changes and innovations.

- Decentralizing SIP data would add complexity to the system, as well as uncertainty and suspicion about customers receiving best execution.

## Panel Five: Governance of Core Data Infrastructure

This panel discussed potential steps to improve the governance of Core Data Infrastructure, including: NMS plan governance; conflicts of interest; transparency; voting rights; and the Operating Committee's standard of care.

The panelists were from Invesco, BlackRock, Cboe, CHX, Citigroup and IEX. Richard Ketchum, the former Chief Executive Officer of the Financial Industry Regulatory Authority and a former Director of the SEC's Division of Trading and Markets, also participated on the panel.

Discussion Summary:

*Conflicts of Interest*

- BlackRock, which serves on the advisory committees of three NMS plans, noted the conflicts of interest inherent in the structure of NMS plans – specifically, exchanges, as self-regulatory organizations, have a "disproportionate influence" on both the design and operation of NMS plans. Moreover, they do not represent the securities industry as a whole, as they are for-profit entities whose economic interests lie in tension with the management of their regulatory responsibilities.

- BlackRock suggested certain concrete steps that could be taken to address such conflicts of interest and facilitate more informed and impartial governance of the NMS plans including: (i) broadening governance to include a diverse range of market participants (such as broker-dealers, investors, issuers and vendors) ; (ii) providing equitable voting representation to advisors; (iii) adopting a conflict of interest policy to address the core conflict between SIP and proprietary data feed interest; and (iv) limiting the use of executive sessions to issues requiring confidential treatment.

- Mr. Ketchum suggested that conflicts of interest could be managed by creating compensation incentives tied to the performance of the SIP as well as proprietary products.

- Citigroup noted that conflicts of interest were increasingly present as exchanges became for-profit entities that answered to their shareholders rather than to the broader market. Citigroup identified the issue as the "quasi-regulatory, fully commercial nature of exchanges."

*Two-Tiered Data Feeds*

- BlackRock questioned whether providing a direct data feed alongside a public data infrastructure was consistent with the promotion of fair and orderly markets. Private market data products, which did not exist when the market data plans were originally established, directly compete with the SIP data feed. Speed disparities and latencies in the SIP data feed raise public interest concerns, prompting BlackRock to ask whether the two feeds should be put under the same governance framework.

- Invesco, which described market data as a public utility owned by all, agreed with the concerns about two-tiered data feeds, and further noted that certain market participants can buy an advantage relative to others without being subject to any additional obligations. Invesco expects that this advantage would continue to be present if the SIP is expanded to include additional data because exchanges would enhance their data fields, thus providing an advantage to opportunistic traders who have no obligation in the marketplace.

- Cboe questioned underlying assumptions regarding the divergence of interests between proprietary data feeds and the SIP, noting that despite selling a competing product commercially, the exchange is incentivized to make the SIP as strong as possible.

*Transparency*

- Invesco stated that the best way to manage the market data structure is through transparency and broader representation of different marketplace constituents on NMS plan and SIP committees.

- CHX highlighted steps that had been taken by the NMS plan Operating Committee to improve governance transparency, including: decreasing the length and use of executive sessions; publishing summaries of general sessions on the internet; and publishing executive session agendas on the internet.

- While Cboe voiced support for transparency and disclosure about executive sessions, it noted that a “continuous disclosure regime” could prove impractical or unhelpful.

*Increased Participation and Voting Rights*

- CHX noted certain steps that recently were taken to increase advisor participation in NMS plan governance, by requiring that advisors review Operating Committee actions prior to the actions being taken, and provide input before the revenue allocation formula is increased.

- IEX advocated for a fundamental change in the composition of committee voting and representation, and stated that a vote for the advisory committee would create a balanced board structure, similar to those in place with the exchanges and FINRA, to address similar conflicts of interest.

- Cboe agreed that enfranchisement of advisors would be a step in the right direction, and stated that recusing a specific individual from a particular vote would not address when the operator as a whole is making a decision, rather than an individual with a specific economic interest.

- Cboe noted its belief that because exchanges have a higher obligation, they should have higher voting power.

- Citigroup noted that voting rights are inextricably tied to transparency, as those with a vote are informed of actions taken by the Operating Committee.

- Mr. Ketchum expressed support for giving a vote to an individual representing the public, but also noted that there is no provision in the plans to provide an advisory committee member with a vote. He added that anyone with a vote should be held accountable by the SEC.

- Mr. Ketchum also emphasized the importance of the advisory committee, both from an expertise standpoint and in its role as arbiter.

- Invesco, BlackRock, IEX, and Citigroup all supported granting one vote per exchange operator or group, rather than one vote per exchange. Mr. Ketchum and Citigroup noted, however, that some reflection of market size would be fair.

- CHX wishes to retain the current construct and noted that if the voting structure is changed, minority rights (*i.e.*, CHX, which currently has one vote) must be protected. BlackRock stated that voting by exchange group, rather than by exchange, would increase the voting representation of minority exchanges.

*Creating Fiduciary Obligations of the Joint NMS Plan Operating Committee*

- CHX stated that the plan is silent as to the obligations of the Operating Committee, and that a lack of formalized obligations did not have any practical adverse impact on the committee to date. Further, the requirement for unanimity to make changes to the plan serves as a check and balance.

- Mr. Ketchum noted that imposing fiduciary responsibility on members of a plan could allow the SEC to hold responsible SRO participants in the plan from an oversight and legal standpoint.

*Executive Sessions*

- CHX underscored the importance of executive sessions for confidential issues, such as audit findings and litigation matters.

- IEX stated that "confidential" should be differentiated from "sensitive" (*e.g.*, potentially exposing committee members to criticism).

- IEX and BlackRock expressed concerns about the carve-out allowing executive sessions and the lack of a continuing obligation by the Operating Committee to narrow the use of executive sessions.

## Panel Six: Funding of Core Data Infrastructure

This panel focused on potential steps to assure adequate funding of a modernized Core Data Infrastructure, and that the associated fees and revenues are fair, reasonable, and not unreasonably discriminatory. The panelists discussed issues related to the costs of market data and exchange fees, as well as transparency in setting fees.

The panelists were from Bloomberg, IEX, Quantlab Financial, Fidelity Investments, Cboe, Tabb Group; and Nasdaq.

Discussion Summary:

*Relationship between Costs and Fees*

- Bloomberg, Fidelity Investments, and IEX noted that there must be a relationship between the actual costs of producing market data costs and market data fees. They advocated for examining these costs and streamlining the administrative process of data production and dissemination to lower the overall costs.

- Quantlab and Fidelity Investments emphasized the role of governance in streamlining the administrative process.

- Cboe remarked on the inefficiencies of a cost-plus model and the difficulty of evaluating fee reasonableness with respect to exchanges, all of which have different business and operating models.

- Cboe also noted that information distributed to the SIP is costly to produce and highly useful for the domestic equity market. The exchange challenged the notion of data products as having a monopoly.

- IEX described the SIP as a utility, and indicated that in determining a reasonable relation between costs of production and fees charged, the costs should be attributable (or at least allocable) to different operational aspects of producing and providing data, including: physical connectivity; logical connectivity; system matching; production and dissemination of market data; and the cost of routing data to other exchanges.

- Nasdaq noted that its exchanges employ “platform theory,” which requires that costs and fees not be evaluated in isolation.

*Transparency*

- IEX contended that transparency was possible, and IEX and Quantlab stressed the importance of transparency with regard to determination of fees for SIP data and exchange proprietary products.

- Fidelity Investments noted that transparency would provide an incentive to drive down costs.

- Cboe noted that exchange-related costs are filed annually through audited financial statements to the SEC, but the Tabb Group noted that 10-K and 10-Q filings do not provide sufficient information to evaluate the allocation of data fees and costs.

- Bloomberg stated that the most useful information is the cost of assembly and dissemination of market data.

*Setting SIP Fees*

- Nasdaq stated that it is dangerous for the SEC to become a “rate-making agency” and reminded the panel that the fees are not skyrocketing, and that disclosure of SIP costs could be a slippery slope. Further, SIP fees have been recognized by the SEC as serving the function of promoting quotes. Nasdaq conceded that it was often difficult for exchanges to determine how much competition is sufficient.

- Nasdaq noted that costs have been stable, and commended the SEC’s efforts thus far, but Fidelity Investments argued that costs should fall rather than be kept stable given the rise of technology and other developments.

- Bloomberg pointed out the obligation of exchanges to maximize shareholder value, and remarked on the presence of both monopoly and competitive functions within exchanges.

## *Panel Seven: Public Transparency*

The final panel focused on the information available to the public about data products and access services, including their associated fees, revenues, costs and respective latencies.

The panelists were from Cboe, Goldman Sachs, Nasdaq, Healthy Markets, Glenmede Investment Management, Succession Systems and RBC Capital Markets.

Discussion Summary:

The non-exchange panelists asked the SEC to require full exchange transparency with respect to SIP costs and all revenues.

- Goldman Sachs requested side-by-side transparency of SIP revenues and proprietary data revenues from each exchange, noting that if some of the revenue data needs to remain confidential, this data should be provided to the SEC for its review in determining whether exchange fees and other charges for SIP data and proprietary data are fair, reasonable and not unreasonably discriminatory.

- RBC Capital Markets suggested that the SEC amend Rule 608 of Regulation NMS to eliminate the immediate effectiveness of certain rule filings (including those related to fees), and to permit public notice and comment before fee changes are approved by the SEC.

- Nasdaq disagreed, stating that Congress mandated in the 1934 Act that certain SRO rule filings, including market data fee filings, be effective immediately.

Panelists also discussed the possibility of live streaming the executive sessions of SIP Operating Committee meetings for greater transparency.

- Glenmede Investment Management noted that recording the meetings could stem productivity or create fewer incentives for participants to speak up, but suggested that releasing the full minutes from the meeting, instead of a summary, could promote transparency as an alternative to live streaming and recording the meetings.

- Nasdaq also discussed the need for confidentiality for advisors in the executive sessions, including regarding sensitive information that might be protected by legal privilege.

- Goldman Sachs argued for a transparency subcommittee within the SIP Operating Committee to consider these issues, including what information should be available only to the SEC and what information would be appropriate to publicly disclose.

This update was authored by:


**K. Susan Grafton**
Partner, Washington, D.C. / New York
+1 202 261 3399 /
+1 212 698 3611
susan.grafton@dechert.com

**Elliott Curzon**
Partner, Washington, D.C.
+1 202 261 33411
elliott.curzon@dechert.com

**Ari Abramovitz**
Associate, Washington, D.C.
+1 202 202 3363
ari.abramovitz@dechert.com

**Keunjung Cho**
Associate, Boston
+1 617 728 7115
keunjung.cho@dechert.com

**Vince Nguyen**
Associate, New York
+1 212 698 3566
vince.nguyen@dechert.com

**Kimberly Thomasson**
Associate, Washington, D.C.
+1 202 261 3418
kimberly.thomasson@dechert.com