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Latest Market Data Dispute Over NYSE's Plan to Charge for Depth-of-Book Data Pits NSX Against Other U.S. Exchanges

The National Stock Exchange filed a comment letter with the SEC supporting a review of the Commision's approval of the New York Stock Exchange's fee proposal as well as a review of the current market data revenue-sharing formula under Reg NMS.

By Les Kovach

What started as a long-shot petition from an Internet-business coalition is turning into an ever-louder debate over market data revenue that has exposed a controversy over the fairness of Reg NMS. In a move that put it at odds with the other U.S. exchanges, the National Stock Exchange (NSX) has sided with the broker-dealer community, which opposes the NYSE Arca's plan to charge for depth-of-book data.

In late 2006, NetCoalition — an Internet-business public policy advocacy group that includes Google, Yahoo and Bloomberg — requested the SEC set aside the Division of Market Regulations' approval of the New York Stock Exchange's fee filing for the Arca Book depth-of-book feed. In a decision that several insiders call nearly unprecedented, just days before the new year, the Commission granted the petition, apparently placing a stay on all exchange plans to charge for depth-of-book and other market data feeds.

The Securities Industry and Financial Markets Association (SIFMA) promptly applauded the SEC's decision. But SIFMA co-CEO Marc Lackritz went even further, calling for a moratorium on all market data rule fee filings for the exchanges, citing the "conflicts of interest inherent in today's for-profit exchanges" and labeling it "a matter of investor protection."

Now that exchanges are for-profit, "it is a massive conflict of interest which needs to be regulated between the interest of transparency and efficiency of the market — meaning an information free-for-all — on one side and the interests of the shareholders of the exchanges," comments Philippe Buhannic, president and CEO of TradingScreen. "Somebody needs to regulate that because otherwise you give monopolistic pricing power to an entity, and that's not fair."

While Ron Jordan, SVP of market data for the NYSE, says the exchange is "hoping the SEC will rule quickly," he acknowledges that he does not know when a ruling may be issued. Jordan notes that although the NetCoalition petition specifically addresses the NYSE Arca Book fee filing, he believes the resulting SEC review also is delaying approval of other exchange market data fee filings, including The Nasdaq Stock Market's fee filing for last-sale data feeds.

According to Markham Erickson, director of federal policy and general counsel for NetCoalition, there is no precedent offering insight into when the SEC will make a decision. But "the SEC has said that the exploration of market data issues is a 'front-burner' issue," he says, speculating that the Commission's 5-0 vote in favor of granting NetCoalition's petition is indicative of the priority the SEC places on the debate.

NSX Stirs the Pot

That debate got more interesting in late February when the NSX filed a comment letter with the SEC urging the Commission to delay approval of the NYSE Arca Book fees and conduct a "thorough, broad-based review of the securities market data structure." Arguing that depth-of-book data is requisite for competitive trading, the NSX recommends exchanges be required to distribute consolidated depth-of-book data as well as top-of-book data. Further, the exchange calls into question the efficacy of the Reg NMS market data revenue-sharing formula, branding the current sanctioned markup for consolidated top-of-book data "excessive" and "arbitrary."

"The industry has not effectively dealt with market data," asserts NSX CEO Joseph Rizzello, who submitted the exchange's letter to the SEC. "Reg NMS tries to deal with market data, ... but it's somewhat of a convoluted formula — everybody is struggling to figure out what it all means."

Rizzello is quick to stress that the NSX does not strictly oppose the NYSE's plan to charge for depth-of-book data. Rather, he explains, the exchange is advocating the industry study the market data structure further before implementing new fees. "Let's have a full, open hearing and briefing on market data," Rizzello says. "If the industry comes together, we can figure this out."

Still, Rizzello makes it clear that the NSX believes charging for depth-of-book feeds creates unfair advantages that Reg NMS was intended to eliminate. "In this new [trading] environment where technology plays such a huge role, top of book is becoming less and less important," he says. "The average investor is at a huge disadvantage to the professional when you're talking about [charging for] depth-of-book data because the professional can pay for it."

It's Just Business

It's just business, suggests the NYSE's Jordan. "The core of this issue is allowing customers to choose what they want to have and what they don't want to consume rather than having the government mandate it," he says.

"The law couldn't have been more clear," Jordan continues. "The SEC did not mandate a consolidated limit-order book. The SEC was very clear that it's only top of book."

The ability to charge for depth-of-book information, Jordan adds, should be determined by market forces. "If firms believe they can get better executions by consuming more data, they have every right to do that," he explains. "But that's more of a competitive issue than it is a legal issue."

But TradingScreen's Buhannic asserts that depth-of-book fees will disadvantage individual investors and hurt the overall markets. "The people who are going to be hurt the most are retail investors, who will have the most difficulty paying [the fees]," he says.

But the pain won't be limited to the retail investor, Buhannic adds. "Because of the cost, people are going to reduce their usage [of the depth-of-book data]," he says. "It means that the traders who trade less actively are going to suffer because now they aren't going to have the same information, and I don't think that is fair. Information in general should be accessible to everyone at a reasonable cost."

The NYSE's Jordan contends, however, that the proposed fees for the Arca Book feed are reasonable. He says the fee would be just $750 a month firmwide, though an additional device fee of between $15 and $30 could easily surpass that total, depending on the number of traders with the feeds on their desktops.

Jordan also argues that the NSX's support of market data reform is a calculated move against its exchange competitors. "From a competitive standpoint, it is in the National Stock Exchange's best interest if it can prevent the New York Stock Exchange and others from collecting market data fees," he contends. "If the NSX can get market data revenue to zero, it hurts the New York Stock Exchange a lot more than it hurts NSX," Jordan adds, contending that the NYSE's data is considered more valuable than the NSX's feeds.

While the NSX's Rizzello concedes that the NYSE has more volume and therefore its data technically is more valuable, he says losing data fees would be more painful for his exchange. "The only revenue we generate is off of market data," he reveals. (According to Rizzello, the NYSE's market share continues to decline while the NSX accounts for more than 25 percent of all quote traffic industrywide.) "This is against our short-term interests," Rizzello continues. But charging excessive fees for market data "is not a long-term plan to sustain our business model."

Reg NMS Falls Short

The bigger picture, Rizzello says, is the long-term health of the U.S. securities markets. While several sources confirm that the NetCoalition petition did not delay the implementation of Reg NMS' new market data revenue-sharing formula, the NSX believes the industry should reconsider the plan.

Rizzello contends that Reg NMS reinforces the exchange market-data monopoly, stifling competition and allowing the exchanges to continue to charge an excessive markup for top-of-book data. "We don't believe the current market data formula works, and it's obvious because the broker-dealer community is coming out strongly against the current scheme," Rizzello says.

TradingScreen's Buhannic is among a growing contingent of industry participants who agree with Rizzello and SIFMA. "If you take out the exchanges, nobody would dispute that the exchange fees are [excessive]," he says.

"In every area of business, including the financial industry, you reach economies of scale, which means that usually the end consumer benefits from a reduced cost at some point," Buhannic continues. "The model of market data is very interesting because [systems] are a lot cheaper every day, communication and bandwidth is a lot cheaper, storage is a lot cheaper every year — but the price keeps going up, which is really going against the interest of the market because data brings transparency and efficiency — efficient information makes for an efficient market. Data should be a commodity; [the price] should be based on the cost."

"At the end of the day, the industry recognizes and understands that the amount of money that is derived from market data is far more money than it costs to produce it," the NSX's Rizzello says. "We can identify what it costs us to produce our depth-of-book feed and all other exchanges can do that as well," he asserts, adding that the industrywide cost to produce top-of-book data is between $40 million and $50 million a year while current top-of-book revenue is about $450 million. "The NSX's feeling is that you should put [top-of-book and depth-of-book] data out there for what it costs."

Not only does the NSX recommend a cost-based model for market data fees, it also advocates a plan in which market participants are charged only when they act on the market data, rather than for simply eyeballing it. Rizzello proposes a standard fee be added to executions to cover market data costs, similar to the way the SEC collects funds to cover regulation expenses.

As overall trading volume goes up, the per-transaction market data fee would come down, Rizzello adds. "The industry knows overall what it costs to produce consolidated top-of-book market data," he asserts. "Put it all out there and only charge what it costs to produce it."

But, "The SEC has examined cost-based pricing and dismissed it at least three separate times as unworkable," the NYSE's Jordan counters. "One of the big issues with cost-based pricing is defining what 'cost' is," he argues.

"A reasonable person could say that the costs of producing the market data that comes from the New York Stock Exchange is the cost of every system that gathers it and helps execute it," Jordan continues. "It's very hard to decouple market data from everything else an exchange does — execution is intertwined with market data."

What Drives Innovation?

The NYSE and the Exchange Market Data Coalition contend that the revenue generated by market data funds innovation among the exchanges. But the NSX's Rizzello says competition fuels innovation. "If the raw market data is out there — both top of book and depth of book — there's lots of innovation and creativity that can come around that to produce even more-powerful tools in the use of market data," he explains.

"Whoever is innovative and creative with [the market data] should be able to charge whatever the market bears for it," Rizzello adds, stressing that exchanges could compete with third-party providers. "Exchanges are becoming more and more technology providers. ... We can take raw data and turn it into something that is more valuable than what's produced in the marketplace today, and folks are more willing to pay for it."

The NYSE already has a data product the market is willing to pay for, the exchange's Jordan points out. He says the current stay on the NYSE's fee filling "is hampering our ability to give information to customers who have requested it and want to start using it." But Jordan also says, "Arca Book is still out there, the same way it was before we filed for fees."

One institutional sales broker who requested anonymity because he wasn't authorized to talk about the issue says he believes he already pays for the Arca Book product. One thing he was certain of, however, was that if the SEC allows the NYSE and other exchanges to charge for depth-of-book data, the individual investor will pay for it.

"Those costs will clearly be passed on to the investors," agrees the NSX's Rizzello, who says his exchange has no plans to charge for its depth-of-book feed, even if the SEC approves the NYSE's fees. "Archipelago and INET gave their depth-of-book data away for nothing for years and it worked to their advantage — they gained tremendous market share," he explains. "Our view right now is to give our depth-of-book market feed to our customers for nothing."