published: 5.22.00

May 22, 2000

U.S. Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Attn: Jonathan G. Katz, Secretary

Re: Securities Exchange Act Release No. 42208, File No. S7-28-99

Ladies and Gentlemen:

The Bond Market Association ("Association")[1] welcomes the opportunity to comment on the Securities and Exchange Commission's recent concept release on market data fees and structures.[2] The concept release provides a thoughtful and comprehensive review of the issues related to the current distribution mechanisms for market data in the equity and options markets. We especially commend the Commission's commitment to ensuring that Exchange Act goals are fully reflected in all aspects of market data collection and dissemination.

The Association's primary concern with the market data structure is whether the underlying principles of the existing system should automatically extend throughout the securities markets. Current market data structures operate for options and equity products and do not implicate the fixed-income markets.[3] Nevertheless, price transparency, market structure and centralization, which are issues at critical stages of development in the fixed-income markets, are also implicated by the existing market data scheme. Whatever reforms the Commission undertakes in the existing market data arena may be used as guidance in developing systems for the fixed-income markets. In addition, Commission staff has encouraged the Association to comment on the concept release in the interest of gathering the most complete views on this important market issue. Accordingly, the Association wishes to express the views of its members on the concept release.

I. Executive Summary

- The Association believes that the existing market data structures for options and equities should not be used as a model for developing market data systems for fixed-income securities.
- Market participants that contribute market data should share in the revenues generated by the sale of this data.
- The Commission should encourage an open architecture that allows for multiple channels for reporting and disseminating trade data. Regulatory efforts should focus on creating common standards for competitive entities to follow in performing the collection and dissemination of basic market data that are tailored to the needs of fixed-income securities.

II. History of the Existing Market data Structures

The current market data system was adopted in the wake of the 1975 amendments to the Securities Exchange Act of 1934 ("Exchange Act"), which called for the creation of a national market system for securities.[4] Congress identified core principles upon which a national market system should be based, including fair competition, widespread transparency, efficiency and best execution. Congress saw "[t]he linking of all markets for qualified securities through communication and data processing facilities" as essential to achieving these goals.[5]

Congress also recognized that all securities would not benefit equally from a uniform set of national market system rules and gave the Commission considerable discretion to implement only those rules it deemed necessary in the public interest to effect the national market system's goals. The principal limitation imposed by Congress was that the Commission was not to approve any aspect of the national market system that imposed an unfair burden on competition, unless such a burden was necessary to effect the Exchange Act's goals. This foresight has enabled the Commission to avoid overly rigid rules that would jeopardize the stability and integrity of the markets for securities with unique characteristics. Historically, the Commission has recognized that the unique characteristics of fixed-income securities in many cases warrant treatment different from that appropriate for equity securities.

Cross-market transparency for multiply-listed, continuously-traded securities is a central aspect of the national market system. Congress envisioned a system of securities information processors that would collect and disseminate information about securities transactions to implement this transparency. While Congress required any processor that was operated as the exclusive source of information from an exchange or group of exchanges (or national securities association) to register with the Commission, it did not require the implementation of the sole-source model and indeed recognized that many providers would not have a monopoly over the information they distributed. Rather than dictate the exact model to be used, Congress granted the Commission broad authority to foster development of the national market system without mandating the specific features. Congress specifically included the possibility that the national market system "may include subsystems for particular types of securities with unique trading characteristics."[6]

In response, the Commission required the consolidation of market data (i.e., bid and ask quotations and last sale information) for certain securities.[7] The Commission approved the formation of joint ventures by the national securities exchanges and the National Association of Securities Dealers, Inc. - the self-regulatory organizations for the brokerage industry - to accomplish the task of consolidating and disseminating market data for equities and options from among their various markets. This consolidated data was considered critical to a fair and orderly price discovery process for these securities.

Although the current market data model may be appropriate for those securities, the Association believes that the same model need not be repeated in the fixed-income arena in order to effectuate the Exchange Act's principles. To the contrary, the Association believes that such a model is not appropriate for the fixed-income markets. Instead, development of a competitive model would more effectively carry out the Exchange Act's goals in this environment. A competitive model would allow development of data products more suitable to pricing fixed-income securities, while at the same time avoiding the disadvantages of the existing model. Moreover, a competitive model would deliver products offering better service and efficiency at lower costs.

III. Competitive vs. Monopoly Models

The Commission has a rare opportunity in fashioning market data initiatives in the fixed-income markets. Initiatives in this area, such as the NASD's Trade Reporting and Comparison Entry Service ("TRACE") proposal[8] and the Association's Corporate Trades I product (developed in conjunction with GovPx) are in their early stages. The Commission should adopt standards to guide the development of these initiatives according to a modern, competitive model for data collection and dissemination that more accurately reflects the electronic environment that now pervades all aspects of the securities industry, while concurrently ensuring the basic regulatory protections.

A. The Deficiencies of the Existing Model

The deficiencies of the existing model can be avoided for the fixed-income markets by favoring a marketplace approach. The existing model for equity-data facilities is a monopoly service operated by the self-regulatory organizations. As such, the model contains inherent conflicts. As a monopoly service provided by the SROs, the market data systems currently generate excess revenues that are used for subsidizing other SRO functions, such as market surveillance and regulation. The Association is fundamentally opposed to any subsidization of market surveillance or regulatory functions by revenues generated from a market data service. Subsidization practices act as a disincentive to developing more efficient services, as any additional costs that are the result of inefficiencies are absorbed painlessly by the subsidy. Direct costs associated with market surveillance and regulation should be recoverable, but revenues in excess of these costs should be distributed to those entities, such as broker-dealers, that contribute data.

Further, as appears to be the case with the current system, the alleged need for funding of market surveillance or regulatory services is used to justify excessive fees charged to a captive audience. For example, several exchanges and the NASD have used market data fee revenues to subsidize competitive payment-for-order-flow programs. The existence of such programs undercuts claims that the fees are needed to cover regulatory expenses. This practice is particularly troubling given that the market participants who currently provide the data that becomes the consolidated stream do not benefit from the revenues generated from this information unless they are eligible to participate in the specific payment-for-order-flow programs.

The Association believes such uses are contrary to the sprit of the Exchange Act's demand for equitable treatment of market participants. On the contrary, the Association firmly believes that market participants generating the data that contributes to the consolidated data stream should be able to share in any revenues from the sale of market data. These market participants add value to the consolidated stream and incur costs for creating and supplying this data. A competitive environment could resolve this by providing an economic framework for market participants to negotiate with data consolidators and distributors to obtain a fair value for the data they contribute.

In addition, the governance structures for the current market data plans do not adequately represent the interests of all market data consumers. Both the New York Stock Exchange ("NYSE") and Nasdaq disagree with this view, claiming that their participation in the governance of the market data plans ultimately reflects the interests of those consumer groups because their respective boards of directors include public and industry representatives.[9] Nonetheless, in many instances the plans have not operated consistently with the interests of the broader base of market data consumers, including broker-dealers. Consequently, we believe the interests of the major market data consumer groups, particularly broker-dealers, should be adequately represented in any market data governing body.

A further concern is the possibility that an exchange might become a for-profit organization. For-profit exchanges will exacerbate concerns about sole-source providers. For-profit exchanges may be pressured to reduce funding of the data plans to enhance overall profitability, undermining the integrity of market data. They may also be pressured to raise data fees to enhance profits.

B. Data Reporting vs. Dissemination

The Association wishes to clarify that it does not object to transaction reporting to a regulatory body to accommodate regulatory oversight responsibilities; its concern with the dissemination of that data, however, is twofold:

First, real-time data dissemination should be assessed and phased in, as discussed in the Association's comment letter on the NASD's TRACE proposal,[10] to avoid any detrimental impact on liquidity for less active issues. As discussed in that comment letter, liquidity of less-active issues could be substantially harmed by immediate dissemination of trade data.

Second, no single body -- particularly a regulatory body that may become a for-profit organization -- should be entitled to a monopoly over the dissemination of market data. A competitive model is more appropriate for the fixed-income markets as it can better respond to the sophisticated pricing models relevant to fixed-income securities and can lead to more innovative and efficient products.

C. A Competitive Model is More Appropriate for the Fixed-Income Market

The Association recognizes the concern that effective price transparency relies on the dissemination of uniform, consolidated data. However, the Association does not believe that the only means to achieve this is through the current equity model, which confers a monopoly on the self-regulatory organizations operating through joint ventures to collect and distribute the data.

The Commission should encourage an open architecture that allows for multiple channels for reporting and disseminating trade data. Regulatory efforts should focus on creating common standards for competitive entities to follow in performing the collection and dissemination of basic market data that are tailored to the needs of fixed-income securities.

Beyond these basic standards, the Commission should leave enhancements to the information collectors and vendors to determine in meeting customer needs. Substantial investments will be necessary to develop reporting mechanisms for fixed-income securities. These investments should not be required by regulatory initiative according to a single model, but should be the result of competitive forces in the market. A competitive model based on uniform regulatory standards will allow flexibility among the information collectors and vendors to build tools and information into their products that are useful for pricing fixed-income securities while preserving regulatory goals.

If a single consolidator is deemed necessary, however, the Association believes that commercial data vendors that are unaffiliated with any self-regulatory body should have the opportunity to compete for the chance to be selected as the sole consolidator.[11] Such an approach could assure a cost-effective model for the consolidation of market data and would avoid any need to establish and monitor reasonable cost-based fees or a fair rate of return.

Processors operated as exclusive sources of information from a market would be required, of course, to register with the Commission. These processors would be required to make market data available on a reasonable and non-discriminatory basis and to supply this information to the regulatory and self-regulatory organizations for surveillance purposes. They should not, however, be permitted to restrict in any manner the dissemination of data by market participants not exclusive sources on whatever basis they chose. Moreover, a sole-source consolidator's fees should be limited to those necessary to cover its costs for collecting, consolidating and distributing the data.

IV. Conclusion

The Association's members urge the Commission to consider these comments as the Commission and the industry pursue the development of market data mechanisms for the fixed-income markets. The Association's members are especially opposed to any reliance on the monopoly model as it is outdated and prone to inefficiencies and inequities, concerns exacerbated when the monopoly is operated by a regulatory body, even more so by a for-profit regulator. Most importantly, however, the monopoly model is inherently at odds with the innovative approach to problem solving that is critical to success in today's fast-paced business and technological spheres.

While a competitive model may take many forms, the Association believes that the principles underlying such a model will benefit the market and should be the basis for continuing development of market data mechanisms.

Should you have any questions or desire any clarification or additional information regarding any of the matters discussed in this letter, please do not hesitate to contact Michel de Konkoly Thege, Vice President and Associate General Counsel of the Association, at (212) 440-9476.

Sincerely,

/s/ Vincent P. Murray

Vincent P. Murray
2000 Chairman
Corporate Bond Division of *The Bond Market Association*

cc: *Securities and Exchange Commission* :
The Hon. Arthur Levitt, Chairman
The Hon. Norman S. Johnson, Commissioner
The Hon. Isaac C. Hunt, Commissioner
The Hon. Paul R. Carey, Commissioner
The Hon. Laura S. Unger, Commissioner
Annette L. Nazareth, Director, Division of Market Regulation
Robert L. Colby, Deputy Director, Division of Market Regulation

---

Notes

1. The Association represents securities firms and banks that underwrite, trade and sell debt securities, both domestically and internationally. More information about the Association is available on its Internet home page at www.bondmarkets.com. This letter was prepared in consultation with the Association's Corporate Bond Price Transparency Steering Committee, Corporate Bond Legal Advisory Committee and Legal and Compliance Steering Committee.
2. Exch. Act Rel. No. 42208 (Dec. 9, 1999), 64 Fed. Reg. 70613 (Dec. 17, 1999).
3. We note that one exception is in the municipal bond market. The Municipal Securities Rulemaking Board collects and aggregates market data relating to municipal bonds and disseminates the consolidated data for free. We wish to emphasize that the views expressed in this letter are not intended to suggest that this system be disturbed. Instead our views are intended to set forth principles to guide the development of systems for sectors of the market that do not currently have data-distribution mechanisms.

4. Pub. L. No. 29, 89 Stat. 97 (1975)("1975 Amendments"); see also S. Rep. No. 94-75 (1975), reprinted in 1975 U.S.C.C.A.N. 179; H.R. Rep. No. 94-229 (1975), reprinted in 1975 U.S.C.C.A.N. 321.
5. Exchange Act section 11A(a)(1)(D).
6. Exchange Act section 11A(a)(2).
7. Exchange Act rules 11Aa3-1 and 11Ac1-2.
8. Exch. Act Rel. No. 42201 (Dec. 3, 1999), 64 Fed. Reg. 69305 (Dec. 10, 1999).
9. See letter from James E. Buck, Senior Vice President and Secretary, New York Stock Exchange, Inc. to Jonathan G. Katz regarding File No. S7-28-99 (April 10, 2000); letter from Joan C. Conley, Corporate Secretary, The Nasdaq Stock Market, Inc. to Jonathan G. Katz regarding File No. S7-28-99 (received April 13, 2000).
10. See letter from William H. James, III Lazard, Fréres & Co. LLC, Vincent P. Murray ABN AMRO Incorporated and Ferdinand Masucci Morgan Stanley Dean Witter & Co., Inc. on behalf of The Bond Market Association regarding File No. SR-NASD-99-65 (Feb. 9, 2000).
11. In this regard we note Fidelity Investment's proposal for opening the consolidator function to a competitive bidding process. Letter from Eric D. Roiter, Fidelity Investments to Jonathan G. Katz regarding File No. S7-28-99 (April 12, 2000)