FINANCIAL INFORMATION FORUM

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July 9, 2004

Jonathan G. Katz, Secretary
U.S. Securities and Exchange Commission
450 Fifth St. NW
Washington, D.C. 20549-0609

Re: Regulation NMS
Release No. 34-49749; File No. S7-10-04

Dear Mr. Katz:

The Financial Information Forum (FIF) appreciates the opportunity to comment on the above referenced proposed new rules, which considers redesigning the existing National Market System (NMS) rules adopted under section 11A of the Securities Act of 1934. We sincerely appreciated the opportunity to present at the Securities and Exchange (SEC) Hearings on NMS in New York City on April 21, 2004. We were impressed with the testimony and the Commission and staff participation in ensuring a worthwhile dialog.

Formed in 1996, The FIF addresses the issues that impact the market data and securities processing industry - providing a collaborative environment for subscribers to benefit from technology, regulatory, and market innovations. FIF Subscribers include vendors of brokerage information and processing services, exchanges, ECNs and broker-dealers. FIF is organized into committees that regularly meet to review relevant issues. The Market Data Committee addresses a wide range of issues related to the dissemination of market data. Another committee, the Market Data Capacity Planning Committee, focuses specifically on the issues of system capacity requirements as real-time peak message rates for market data continue to climb significantly. The End of Day Committee focuses specifically on issues related to evaluation of closing prices. Members of the FIF Service Bureau Committee are service bureaus that operate real-time order systems and back office brokerage processing data centers for approximately 1500 broker/dealers. These committees have been involved with the review of this proposal, and their members have contributed to this letter.

FIF participants focus on critical issues and productive solutions to technology developments, regulatory changes, and other industry changes. The FIF has previously worked closely with regulators and industry utilities on technical implementation considerations for such projects as industry-wide Y2K testing, OATS, INSITE, Decimalization, Straight through Processing, TRACE and the Patriot Act. We are currently working with NASD, MSRB and NSCC on the implementation of Real Time Trade Matching (RTTM) and with the NYSE on the Order Tracking System (OTS).

The Proposed Regulation NMS opens the door to improvements in the U.S. equities markets. In this competitive environment, it is likely that most markets will introduce changes to enhance their efficiency and quality. While the market changes themselves are important, it is equally important that the changes be implemented in the industry's information and transaction systems in an effective and efficient manner. It is important that the markets work interactively with brokerage industry firms and service providers when changes are planned. Traditionally the Securities and Exchange Commission also considers the impact of changes on the brokerage information system infrastructure when drafting filings for changes.

Our comments on Regulation NMS are based primarily on the perspective of market data vendors, their customers and the service bureaus that provide computer-processing services to broker-dealers. The industry infrastructure for disseminating market data is complex and precise. When data or format changes are made, there is an impact on all downstream systems that receive and process this information in both real-time systems and historic databases. Service bureaus provide standardized systems as well as customized services and interfaces to meet the unique requirements of each client firm. When system changes are required, market data vendors and service bureaus must work individually with each of their clients to implement a program that includes software development, testing, training and migration of changes into production systems and brokerage operations. The service bureau environment, in many respects, is similar to the in-house systems of large broker-dealers. However it differs significantly in its need to deal with many different external organizations with different capabilities and business profiles. The implementation of any system changes in each of these multi-client environments must allow time for the various planning, development and operational rollout tasks.

FIF participants have studied the proposed Regulation NMS to identify potential market changes and their impact on industry systems. FIF organized a Roundtable Seminar for their subscribers on April 13 where we discussed and debated the NMS Concept release. FIF has previously issued documents detailing the industry's market data dissemination infrastructure and the industry's front office order flow processes. Representatives of our participating organizations have met and documented areas where there is a consensus of concern. These areas are:

1. Trade-Through Rule

While FIF membership did not reach a consensus on all of the details regarding the potential changes to the trade-through rule, there are some points of agreement and concern. Regarding the opt-out option, our concern is that the opt-out indication and confirmation would require major changes to the order processing and confirmation systems that a broker-dealer or service bureau runs. There is also some concern regarding reporting the NBBO (National Best Bid/Offer) price to a customer who elected to opt-out from the trade through rule. Most order systems do not have ready access to market data and a complex tracking/reporting mechanism would need to be developed. The FIF does not take a position on how the trade through rule is revised, as long as the revision results in reasonable system changes and enough time is allowed to properly test and implement required system changes.

2. Sub-Penny Pricing

The FIF fully supports the ban on sub-penny pricing, as defined by the proposal. Sub-penny pricing has the potential for greatly increasing system capacity requirements for all industry systems without improving market quality. Sub-penny pricing decreases market depth at NBBO and may enable "stepping ahead" where limit order prices are improved by an insignificant amount to jump ahead of other orders. Clearly, sub-penny pricing does not provide benefits to market participants. The migration from two decimal pricing to three or four (or beyond) decimal pricing will require potentially extensive system changes to accommodate price field expansion in numerous software applications along with the associated testing and deployment costs of these changes. If sub-penny pricing is allowed, there would be a marked increase in the volume of price quotes, and the flow of market data might increase exponentially. Accommodating such an increase would stress existing infrastructure, and participating firms would bear the added expense of increasing market data capacity. FIF agrees with the ban on sub-penny pricing.

3. Market Data

This is the area that is of greatest concern to our participants. Market data dissemination systems have developed over the past 25 years to deliver real-time quotation and trade data without delay or discrimination in an environment of ever-increasing peak message rates. To achieve communications efficiency, data formats are tightly defined. When changes are made, these changes must be addressed in central "ticker plant" systems, communications systems, user site systems and applications that use market data. Concerns focus on new market data display requirements and increased message traffic rates. The SEC document points out that current market data fees cover the cost of market regulation in addition to the cost of collecting and disseminating the data. The market data fees should relate to the cost of gathering and disseminating market data but not market regulatory costs. If market data fees are significantly reduced (through the elimination of regulatory fees) it is likely that that the complexity of market data fee administration and audit could also be reduced. We believe the SEC should encourage the Plans to simplify and standardize reporting requirements across the industry to reduce the indirect administration costs of market data.

Regarding the sharing of revenues from market data among plan participants, the SEC has proposed a departure from the current formulas. This, of course, is primarily a concern for the markets themselves. However, there is a proposal for implementing a NBBO Improvement Share of the revenues. While this sounds like a good idea on the surface, it brings with it two major potential problems. The first potential problem is the complexity of the calculation. Presumably the plan consolidator(s) would do the calculation. We question if the added burden of calculating and auditing the value of the NBBO Improvement Share is justified. The second potential problem is that there may be an incentive for manipulation of quotes by participants for the purpose of increasing their share of revenues. Theoretically, there may benefit to the market through increased liquidity; however, FIF does not support this proposal. A much simpler formula that allocates revenue based on dollar value of transactions by security would seem to foster the goal of eliminating practices aimed at proliferating either quotes or trades while refocusing market participants on their real job, which is serving customers' execution requirements.

Regulation NMS proposes to reduce the requirements on market data vendors and users in that they would be required to distribute only the National Best Bid/Offer (NBBO) and not the quotes and trade reports from all of the participant markets. The FIF supports this change because it will give vendors and users more flexibility in offering a level of data appropriate to various types of users. The consensus among most firms is that allowing a breakout of market data fees to include the NBBO, and any additional add-ons would result in a more equitable pricing structure for market data fees.

Regulation NMS also proposes changes to governance of the three National Market System Plans. FIF supports the concept of expanding the plan governance organization to include more representation from various industry segments including broker-dealers and vendors. Non-SRO members of the Plan governance organization should be a part of the discernment and decision process. They should be informed of proposed changes and given opportunity to comment.

With regard to consolidation of market data, FIF suggests that the current model of a single consolidator for each plan has worked well for the industry. As compared to a multiple-consolidator concept, the current single-consolidator model is efficient and avoids the potential problem of apparent discrepancies in data (mostly because of system timing issues) when different parties make calculations. We also agree that participants should be free to sell market data outside of the three plans where they have proprietary information of interest to the markets apart from the NBBO. The SEC's usual requirement of fair and reasonable terms that are not unreasonably discriminatory should be maintained. We believe the SEC should encourage the Plans to simplify and standardize reporting requirements across the industry to reduce indirect administration costs of market data.

Overall, there is a concern for implementation schedules. The brokerage industry information infrastructure is a multi-layered configuration. Broadcast and transaction messages flow among markets, brokers, service bureaus and market data vendors in a complex and interdependent manner. When changes are made, careful coordination and planning is required among all affected parties. This includes system development, specification changes, internal and external testing and user education. All of these areas are critical to an effective transition and sufficient lead-time must be allotted to assure seamless execution.

We hope that you find the above comments useful. We are sure that these important NMS discussions will continue and we look forward to participating in the dialog.

Respectfully submitted,

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