

**INTERACTIVE BROKERS  
THE TIMBER HILL GROUP**

**TWO PICKWICK PLAZA  
GREENWICH, CONNECTICUT  
(203) 618-5800**

**David M. Battan**  
Vice President and General Counsel

March 31, 2000

**VIA HAND DELIVERY**

Jonathan G. Katz, Secretary  
Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20549

***Re: Regulation of Market Information Fees and Revenues, File No. S7-28-99***

Dear Mr. Katz:

Interactive Brokers, on behalf of itself and its parent company, The Timber Hill Group<sup>1</sup>, respectfully submits these comments on the concept release issued by the Commission regarding the fees charged by the regulated monopolies that are responsible for providing market information to the investing public. Because timely and accurate

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<sup>1</sup> The Timber Hill Group includes Timber Hill LLC, Interactive Brokers LLC and other affiliates which, through the use of proprietary communications technology, trade standardized derivative investment products on organized securities and futures exchanges worldwide. Timber Hill LLC is registered with the Commission as a broker-dealer and is a member in good standing of the Chicago Board Options Exchange, American Stock Exchange, National Association of Securities Dealers, Philadelphia Stock Exchange and Pacific Exchange. Interactive Brokers LLC, also a registered broker-dealer, engages exclusively in agency trading. It is a member in good standing of the Chicago Board Options Exchange, American Stock Exchange and Philadelphia Stock Exchange, where it offers execution of customer orders in all option classes.

market data is essential in order for retail customers to compete on a level playing field with market makers and other professional traders, we feel strongly that self-regulatory organizations (“SROs”) and the Information Processors that are responsible for disseminating market data should do so completely free of charge, and that the costs incurred by these entities in collecting and distributing such data should be recovered from transaction, membership or other fees that do not create a disincentive to the retail public to trade based on real-time information.

As we show below, the current market data fee structure discourages a substantial majority of the investing public from subscribing to real-time data from the various exchanges and trading venues upon which their trades might be executed. Lack of real-time data causes these customers disproportionately to use market orders when trading, thus giving up the spread on every trade to exchange specialists and market makers who often are affiliated with or are paying broker-dealers for this uninformed, yet very lucrative, order flow. Lack of real-time data in turn makes it difficult for these customers to ensure that their brokers are giving them timely, best-price execution of their trades. For these reasons, among others, exchanges should recoup the costs of regulating their markets and disseminating market data solely from transaction or other fees that do not have the collateral impact of reducing transparency and placing investors at an informational disadvantage to market professionals.

**I. Market Data Fees Discourage Investors from Trading Based on Real-Time Prices and Hamper their Ability to Ensure Best Execution of Their Trades.**

Rapid developments in technology and communications have given investors unprecedented access to the nation’s securities markets and have dramatically altered the way retail investors trade. The growth of the internet and the ability to place their own orders online without having to call a broker or pay hefty commissions have attracted hundreds of thousands of new investors and have changed the way veteran investors interact with the market. Yet as the

Commission has recognized, our system of providing market data to the public has not kept pace with this change and is preventing the investing public from realizing the full benefits of the ongoing revolution in technology.

Prior to the advent of online trading, a customer called his or her broker to inquire about the market for a security or to place a trade. Market data charges were much less important because: a) there were far fewer quote requests given the nature of broker-intermediated trading; b) quotes were relatively less expensive to the customer and the firm when provided on a request-by-request basis over the telephone; and c) absolute real-time price data was much less imperative in any event because trading was far slower (because trades were effected by a series of human interactions rather than by computers interacting at the speed of light).

This has all changed. Access to real-time price data is more important than ever to the average retail investor because technology is now widely and cheaply available that lets customers query the market and execute trades in a matter of seconds, without the help of a broker. Using readily available technology from firms such as Interactive Brokers, ordinary retail customers can display up to twenty or thirty securities of interest on their personal computer screens and execute trades with a simple mouse click. Unfortunately, the benefits of this increased access to the markets is being enjoyed by far too few investors because the aggregate monthly market data fees are often too high to make it worthwhile for other than active traders to subscribe to real-time, streaming prices. Indeed, an astounding number of investors settle for delayed pricing or paying per-quote fees<sup>2</sup> and then trade using market orders rather than limit orders.

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<sup>2</sup> Many online trading systems require customers repeatedly to type in the symbol for a particular security to get a live quote, and then charge a small fee each time. Monitoring the price movement of a particular security (or worse, multiple securities) using this method of obtaining quotes is tedious and inefficient and puts the individual at a distinct disadvantage to the professional traders and market makers whose screens display live, continuously-updated prices and market data.

It should be of concern to the Commission that many, even relatively experienced investors as they have moved “online” have not taken full advantage of the technology that would allow them to negotiate the prices that they pay and receive for securities by using limit orders rather than routinely yielding the spread to the professionals by placing market orders. Market data fees play a large role in this because the delayed or quote-by-quote market data provided by most online brokers to most of their customers (*i.e.*, those not willing to pay \$50.00 or \$75.00 or more per month for “premium” data access) does not provide those customers with sufficient information to trade intelligently against professional liquidity providers. Pervasive use of market orders also deprives investors of the possibility of their orders “interacting directly [with other investors] without the intervention of intermediaries,”<sup>3</sup> as they lose the ability to narrow the spread offered by professional intermediaries and thus execute against other public investors (to their mutual benefit). Direct customer-to-customer trading is a fundamental goal of the National Market System but cannot happen in any meaningful volume unless investors have access to the same real-time prices as the professionals. In short, “[f]or the investor to make sound, financial decisions, efficient and inexpensive access to market data information is vital.” Exch. Act Rel. No. 41499 (Jun. 9, 1999), 64 Fed. Reg. 32910 (Jun. 18, 1999).

In addition to being at a disadvantage by trading on stale data or relying on market orders, lack of real-time price data makes it difficult or impossible for customers to monitor the quality of their executions. Thus, a retail customer who declines to pay for premium data services and uses market orders may not be able to tell whether his broker – who may be preferencing the customer’s trade to an affiliate or receiving a payment from a third-party for routing the order to a certain market – is providing best-price execution of the customer’s order.

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<sup>3</sup> See Request for Comment on Issues Relating to Market Fragmentation, Exch. Act Rel. 34-42450, 65 Fed. Reg. at 10577 (Feb. 23, 2000)

As the Commission noted in its Concept Release: “[R]eal-time market information . . . could greatly expand the ability of retail investors to monitor and control their own securities transactions, including the quality of execution of their transactions by broker-dealers.” 64 Fed. Reg. at 70614.

This problem is likely to grow worse with the proliferation of multiple trading venues offering the same securities. While this trend has increased price competition and should be strongly encouraged, the availability of the same security in different markets makes real-time market data all the more essential to the retail investor, so that the investor can decide where to route his or her order, or so that the investor can monitor the routing choices being made by his or her broker. Yet while making real-time price data even more critical, proliferating markets may increase the aggregate subscriber fees that must be paid by investors to have comprehensive access to real-time quotes.<sup>4</sup>

**II. Market Data Should Be Provided Free of Charge and Costs Incurred by Exchanges and SROs in Operating their Markets Should Be Recovered from Transaction, Membership or Other Fees.**

Because lack of real-time market data puts investors at a severe competitive disadvantage in today’s rapid markets, encourages them to give up the bid-ask spread, and makes it difficult or impossible for them to evaluate the quality of trade execution provided by their brokers, market data should be provided to all investors free of charge. Of course SROs and Information Processors need to fund their operations. However, they should do so through transaction fees, membership fees or other charges that do not have the collateral effect of reducing transparency and putting retail customers at an informational disadvantage to market professionals.

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<sup>4</sup> All or most ECNs currently provide market data to the public free of charge. As the Commission noted in its Concept Release, however, if existing exchanges continue to fund their operations through market data fees, ECNs may feel compelled to do the same. 64 Fed. Reg. at 70628.

The Commission has suggested in its Concept Release that it is considering a “flexible, cost-based approach” to market data fees that would allow SROs to recover, through data fees, both the costs of collecting and disseminating market information as well as some portion of the costs they incur in regulating their markets. We respectfully disagree with this approach.

The problem with this “cost-recovery” approach is that it will provide SROs with unduly wide latitude in allocating their costs to market data production and will provide little real limit on the fees to be charged to investors. Even if cost recovery was limited to the direct costs incurred by SROs in collecting and distributing market data, there would be ample room for exchanges to account for these costs in such a way that they could maintain their relatively high data fees. The Commission’s suggested approach would go even further and allow them to build costs for general regulation of their markets into data fees. If market information fees currently account for 21% of SRO revenues, it is hard to imagine that the SROs could not allocate their costs in such a way that the combined cost of data production and market regulation could be made to equal 21% or more. Under the Commission’s approach it therefore seems unlikely that investors will get any relief.

The wide latitude to be given the SROs in accounting for costs will also lead to continuing disputes over their allocation methods, and will put the Commission in the unenviable position of becoming a ratemaking authority, constantly policing the exchanges’ cost-accounting and market fee charges. The Commission specifically called for comment on this problem in the Release:

“In addition, the Commission encourages commenters to consider the extent to which proposals are capable of being implemented in an objective and reasonably efficient manner, particularly given the other uses to which the Commission's resources could be devoted. In the ratemaking context, courts have recognized that “[i]mplementation is as critical to a policy's success as theoretical design,” and that it is justifiable for an agency to consider its limited resources in formulating a policy.” 64 Fed. Reg. at 70629.

Rather than enter this morass, the Commission should use its rulemaking authority under

Section 11A and work with the exchanges toward a system in which all market data is provided to all members of the public free of charge. This bright-line rule would free the Commission of having to struggle to enforce an ambiguous and pliable “cost-recovery” standard but would also benefit the exchanges in that they would be able to recover lost market information fees by increasing transaction fees, membership fees or other fees. It would also benefit broker-dealers and their customers by eliminating the byzantine data subscription procedures and contracts that must be navigated under the current system.

Of course we understand that increased transaction or membership fees would ultimately be passed on to investors. *See* 64 Fed. Reg. at 70628 (reduction in data fees “would force the SROs to rely more heavily on their other sources of funding--transaction fees, listing fees, and regulatory fees [and] that all of these fees are passed on, directly or indirectly, to investors--the ultimate consumers in the securities industry.”). This is perfectly appropriate and would still offer a substantial improvement over the current system in which exchanges and SROs both recover their market data costs (and more), with high fees **and** profit from trading against the large portion of the public that do not subscribe to real-time data and therefore trade based on insufficient information. In short, under the current system, the public pays twice.

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We realize that provision of market data free of charge would be a substantial departure from the current system of SRO financing. However, the transparency and integrity of our National Market System would be much improved if exchanges did not fund their operations through fees that have the side-effect of distorting the way the market itself functions – reducing transparency and placing hundreds of thousands of retail investors at a competitive disadvantage. It is likely that Information Processors and SROs would not even be able to charge for market data but for their privileged monopoly status in the market system. Providing that they recover

their operational costs through fees that would be less inherently damaging to the market is well within the Commission's discretion under Section 11A and should be the goal for which the industry strives.

Sincerely,

David M. Battan  
Vice President and General Counsel

cc: Hon. Arthur Levitt  
Hon. Isaac C. Hunt, Jr.  
Hon. Norman Johnson  
Hon. Paul R. Carey  
Hon. Laura Simone Unger  
Annette Nazareth, Esq.  
Daniel M. Gray, Esq.  
Mignon McLemore, Esq.  
Anitra T. Cassas, Esq.