Prepared Statement of Randy MacDonald
Chief Financial Officer, Ameritrade Holding Corporation
Before the House Financial Services Committee,
Subcommittee on Capital Markets, Insurance,
And Government Sponsored Enterprises

March 14, 2001

Chairman Baker, Ranking Member Kanjorski, and distinguished members of the Subcommittee, I am Randy MacDonald, Chief Financial Officer of Ameritrade Holding Corporation, one of the larger brokers in the world as measured by what brokers do – buy and sell securities for investors. Including our pending acquisition of Tradecast, Ameritrade is estimated to be a very close second to the largest, Charles Schwab & Co., Inc. Ameritrade represents about four percent of the total volume of the NYSE and NASDAQ, has a little under 1,500,000 accounts, and holds $28 billion of customer assets. Over 98 percent of our trades occur either through the Internet or over our Interactive Voice Response (IVR) system.

I want to thank you very much for the opportunity to testify before you today on behalf of Ameritrade on the subject of improving transparency and competition surrounding public access to stock market data, a matter of increasing importance, particularly given the strong secular growth of the self-directed investor. I look forward to what I hope will be a fruitful and constructive discussion of how we can improve transparency and competition in market data.

There are four fundamental issues that need to be resolved with regard to the current market data model: (1) market data providers discriminate against the on-line investor with their method for charging for quotes; (2) Ameritrade, solely because it acts as an agent, cannot be reimbursed for the costs of collecting and redistributing quotes; (3) revenues in excess of the expense of collecting and redistributing quotes should be returned to the people who provided the quotes -- that is, our customers; and (4) SROs are exercising governmental rights to collect market data fees from market participants and then funding for-profit operations, which compete directly with the market participants from whom they have authority to collect the fees.

Ameritrade's goals are: improved access by the public to market quotation data; promotion of markets via deeper liquidity and trading volume; and promotion of competition in the provision of market quotation data. We believe that markets will flourish when investors have confidence in the integrity and fairness of our markets. Market transparency is the cornerstone of such integrity and fairness, and we believe that a basic and important change that would increase transparency and competition in the current system would be to require SRO exclusive processors[1] to show where the money comes from and where it goes. Tracing the market data fee revenues would probably require an audit at least as frequent as SROs require of listed companies.

To a large extent, Ameritrade is agnostic, so to speak, because our primary goal is to execute trades for our principals as efficiently as possible. Ameritrade is not a market-maker or ECN, we do not internalize our order flow, nor do we profit from principal transactions; we act strictly on an agency basis. We connect to a dozen market centers, and in turn to all US exchanges, most major international exchanges, 7 ECNs, and over 450 market makers. Last quarter we saved our clients over $11 million by getting them inside the NBBO with their executions; last quarter 99% of our orders executed at the NBBO or better. The average Internet execution takes less than 6 seconds to execute, according to information from Keynote.com. 90

[1] SROs are exclusive processors in practice versus law.

percent or our executions take place in less than 60 seconds and 75 percent in less than 10 seconds. We pay between $700,000 and $900,000 per month for market data.

In the 1975 Amendments to the Exchange Act of 1934, Congress chose to place basic reliance upon competition to evolve the appropriate structure of securities markets, with regulators in the role of facilitators. History since that time has borne out the wisdom of that policy. When problems occur, they often relate to attempts to regulate the economics of trading. Fixed commission rates are a prime, pre-1975 example of that kind of failure.

Attempts to fix minimum market-maker quotation sizes between mid-1988 and 1997 are another example of efforts to force the market into a pre-conceived regulatory mold. The minimum sizes merely reduced the exposure of bids and offers and widened the bid-ask spreads paid by small investors in automated systems. These fixed minimum exposure limits (5000 shares in most active stocks) were eliminated when the order handling rules were adopted.

The subject matter of today's hearing is yet another example of regulatory intervention that has not worked well. Market data systems do not work as well as they could today because competition is stifled by exclusive processors' unrestrained, monopsonistic (power over suppliers) and monopolistic control over the collection and distribution of quotation and trade report information.

In its invitation to me to testify, the Subcommittee posed specific questions for Ameritrade to answer. Let me now address each of the committee's questions:

1) What are the benefits of the current regulatory structure governing the collection and dissemination of stock market data?

The main benefit of the current structure is very timely delivery of market data.

2) What are the drawbacks of the current regulatory structure governing the collection and dissemination of stock market data?

The inconsistency of distributing delayed quotes is one drawback to the current system. NASDAQ provides the last sale as well as the bid and ask on a delayed basis at no charge. The NYSE will only provide the last sale.

We also understand that certain market-makers and ECNs are now distributing quotes of executions which occurred at their sites. They do not get charged by the exchanges. They encourage people to use these quotes even though they are not the consolidated quote. People may be mistaken about best execution and accept fills from fragmented liquidity pools when they could have gone to another ECN, market maker, exchange or liquidity pool and received a better price. Although brokers have been carefully regulated on this topic it is not clear that ECNs have fully complied with the spirit of this regulation.

3) What are the regulatory impediments to improving the types and quality of market data provided to investors?

A key impediment to market data access is the regulatory and competitive power of the exclusive processors of market data.

Unlike the National Securities Clearing Corporation (NSCC), exclusive processors of market data are not end-user controlled. Self Regulatory Organizations (SROs) and the processing vendors have contracts that require information producers to give up all proprietary rights in the information submitted to the SRO exclusive processors. Their fees have discriminated against online investors. If an Ameritrade customer obtains a quote from one of our brokers over the telephone, such a quote is free, but if they obtain such a quote from our website they must pay a fee.

Discriminatory fees unfairly burden a selected group of individual investors with unnecessary costs. These costs effectively result in restricting their access to information. In January of 2001, Ameritrade paid nearly $1 million in market data fees to AMEX, NASDAQ, NYSE and OPRA.

These fees are the only fees charged directly to investors, and they reduce the transparency of quotes and the market. Ameritrade believes that there should be a *de minimis* exemption level for quote fees that are charged. This is the largest cost of serving inactive traders, and these fees make it very difficult for brokers to profitably serve the small investor.

4) What are the implications of using stock market data revenues to subsidize regulatory or other SRO functions?

One negative implication is where revenues exceed costs. Exacerbating the anti-competitive features of the current market data system is an absence of restraints on the SROs' use of surplus revenues generated by market data sales. Market participants are charged revenues that are excessive. Rather than returning these excess revenues to market participants, these surpluses are used by SROs to create systems that then directly compete with the market participants. We suggest that the SEC should play a more active role in overseeing the SROs, so that we can avoid a classic case of the fox guarding the hen house.

Such a system requires, and really demands, that someone monitor and adjudicate the issue of whether the "cost" that the utilities incur for gathering and redistributing the tape is in fact reasonable.

Another negative implication is ownership of order flow. The small investor who contributes his/her execution to the consolidated tape receives no benefit of the excess revenues.

Yet the consolidated tape was created by the investor entering his/her order. It seems to follow that the value of the order flow should belong to the people who enter the orders.

We are aware that the NASDAQ now has a practice of rebating tape revenue it receives to certain market-makers for NYSE orders executed in the third market. We believe this is done as a form of revenue share so the market-makers will not contribute such order flow through another exchange, so that exchange can claim the tape revenues for such orders. The contracts of NASDAQ (and possibly CTA Consolidated Tape Association) signed by market-makers, and presumably ECN's, require the participant to give up all proprietary rights exclusively to NASDAQ in the data input into the system. Giving up all proprietary rights to market data prevents the recapture of information production costs by those who input information into SRO systems.

Competition is the best friend of the individual investor. Individual investors are especially dependent upon competitive forces to help them capture the efficiencies of the new technologies. Unlike institutions, individual investors do not have the economic power to require lower commissions and a sharing of the order flow value that their orders help to create. Intense competition at the retail level assures that individual investors can effectively demand the prices and services that they wish. The growth of the online brokerage business is a perfect example of this thesis. If there is a flaw in regulatory processes, it is a chronic lack of faith in the ability of markets to effectively regulate the supply, demand, and prices of securities market services.

5) What is the impact of on-line investing on market data use?

The impact is that it exacerbates all of the problems we are talking about here today.

With exclusivity, and the inevitable lack of competition that accompanies it, comes discrimination against on-line investors and higher investment costs for all. The ability of investors to trade electronically on-line has enhanced their execution capabilities dramatically. Because of the ease and speed with which customers may execute transactions, the demand for, and value of, real time market information has increased because more investors now have the ability to act on that information quickly.

We recognize that in order to collect and process quote and trade information efficiently, market information processors must make considerable investments in sophisticated technology. However, it is also important to recognize that the cost of these investments are passed along to broker-dealers like Ameritrade in the form of membership dues, transaction fees, and market data fees. Ameritrade also incurs significant costs in collecting and disseminating these quotes, and furthermore incurs significant costs in administering the contracts with the exclusive processors. And for many broker dealers who cannot afford to directly access the exclusive processors, they must deal with the additional costs, risks, and administrative burdens of dealing with middlemen.

Ultimately these fees end up as hidden costs to individual, on-line investors – costs that investors do not incur if they simply telephone their broker the old-fashioned way. Not only does this result in disparity of treatment of investors, discriminating against on-line investors, but it also has the effect of preserving inefficiencies in the market that otherwise would be considerably reduced. Market data fees paid by Ameritrade are passed on to our customer base of small, on-line investors, both directly and indirectly. For example, for a customer to get real-time streaming quotes, Ameritrade must pay a monthly subscriber fee of $4 (NYSE, NASD, AMEX and OPRA). If a customer only trades once every two months, which is representative of the average small investor, then Ameritrade's commission is doing no more than recovering the costs of market data.

We know there is no such thing as a free lunch, but something needs to be done to better balance the needs of market information processors on the one hand, with the interests of investors, *all* investors, on the other.

6) What is the significance of transparency of market data terms and conditions to the market?

Because exclusivity breeds problems, there is a strong need for public accountability as an antidote. Exclusive processors should be held accountable to the public by the Congress. To date, the existing authority has not applied the mandates of competition, fairness and transparency contained in the Securities Law regarding the National Market System.

Disclosure, as always, is the best means of preventing abuse by processors of their monopoly power. Accordingly, the SEC should promulgate rules that would provide for public access to the material terms and conditions imposed by exclusive processors in contracts for the provision of market data, and that would require financial disclosure by exclusive processors to allow scrutiny of market data contracts to ensure that they are fair and do not discriminate.

In late July, 2000, then-Chairman of the SEC, Arthur Levitt, announced the establishment of the Federal Advisory Committee on Market Information, to be chaired by Professor Joel Seligman, Dean of the Washington University School of Law in St. Louis. Among the specific market information issues that the Seligman Committee was charged with considering was the value of transparency to the markets and how market information fees should be determined (including the role of public disclosure of market information costs, fees, revenues, and other matters, and how the fairness and reasonableness of fees should be evaluated). We understand that the Seligman Committee may be coming out with its findings soon. We believe that the work of the Seligman Committee will likely provide valuable information that ought to be considered as Congress considers the market data issue. We trust that the Seligman Committee will recognize the danger of declaring market data a “free good.” If such a finding were to be implemented, it would in effect be an expropriation of market data from processors. This would leave the cost of collection and redistribution of market data to be absorbed without any fees to cover the cost. We want to make clear that Ameritrade would not favor such a move. We do not like the current system where processors claim exclusive rights to the market data, which enables them to subsidize other aspects of their enterprise, which compete with market participants. We would be in favor of brokers who enter order information and exclusive processors being able to recover their costs from tape revenue.

In closing, We at Ameritrade want to applaud the efforts of you and your colleagues in Congress, as well as the efforts by the SEC and the Seligman Committee, to address the need for transparency and competition in the provision of securities market data. We stand ready and willing to assist you in any way that we can to find a solution to this problem. We encourage you to act soon, because the sooner these barriers to competition and fair treatment of all investors are removed, the sooner our markets can benefit from the increased efficiencies that will ensue.