

Draft: 13 March 2001

**ORAL STATEMENT OF GERALD D. PUTNAM, JR.
CHAIRMAN AND CHIEF EXECUTIVE OFFICER
ARCHIPELAGO HOLDINGS, L.L.C**

CONCERNING

**PUBLIC ACCESS TO STOCK MARKET DATA - IMPROVING
TRANSPARENCY AND COMPETITION**

**COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE, AND
GOVERNMENT SPONSORED ENTERPRISES**

**UNITED STATES HOUSE OF REPRESENTATIVES
ONE HUNDRED SEVENTH CONGRESS**

MARCH 14, 2001

I. In The Beginning....

Good morning Chairman Oxley, Chairman Baker, and Ranking Member Kanjorski. In late 1996, I founded Archipelago along with software developers MarrGwen and Stuart Townsend. Today, it is a leading electronic communications network, or "ECN," whose owners include Goldman Sachs, E*Trade, J. P. Morgan-Chase, Instinet, Merrill Lynch and CNBC. Archipelago serves a diverse client base and executes over 100 million shares per day, or roughly 6% of Nasdaq volume. Archipelago is also the only ECN to trade exchange-listed shares in the National Market System ("NMS") through ITS/CAES. Beginning only a short 6 months ago and growing rapidly, Archipelago now executes about 8 million shares of NYSE and Amex-listed volume per day.

Last year, Archipelago entered into a business alliance with the Pacific Stock Exchange ("PCX") to create the Archipelago Exchange: the first fully open, electronic national securities exchange for both listed and over-the-counter securities. The Archipelago Exchange will be fully integrated into the NMS and will compete toe-to-toe with the New York Stock Exchange, the American Stock Exchange, and Nasdaq. Our trading rules, which reflect the market structure of the exchange, were published in the Federal Register by the Securities and Exchange Commission ("SEC") in December 2000, and we recently submitted our responses to the SEC to letters commenting on our rules; letters which, I can happily report, were mostly positive.

That notwithstanding, we have now entered into challenging, if spirited, negotiations with the National Market System Plans ("NMS Plans"). Entrance into the NMS Plans is mandatory for any exchange and, unfortunately, creates a substantial barrier to entry. More on that later. In

the end, with plenty of elbow grease and some good fortune, we trust that the Archipelago Exchange will be the first for-profit, technology-driven exchange.

II. Importance of Market Data: “The Life Blood of Markets”

Former SEC Chairman Arthur Levitt has called market data “the lifeblood of markets.” And, before this very Subcommittee two years ago, the SEC’s Annette Nazareth testified that “...[A] market can be defined most simply as exchange of information about the buying and selling interest in a product – in particular, quotations as to the price and size at which buyers and sellers are willing to trade.... A market’s quality depends on the extent to which this information is timely, comprehensive, and reliable.”

Today, market data in our equity markets is governed and controlled by a group of government-mandated, anachronistic and static structure: the NMS Plans. Although organized with good intentions and purpose, we respectfully submit that the NMS Plans – CTA/CQ Plan for listed securities and the OTC/UTP Plan for Nasdaq securities – must be fundamentally improved. Why? The Plans are exclusive providers; any vendor or broker-dealer that supplies data to the investing public must contract with the plans. The Plans engage in ratemaking, albeit subject to the oversight of the SEC. Surely, the words “exclusive” and “ratemaking” sound funny and out of place in a world that has so benefited from prudent deregulation?

Market forces that don’t impact or provide incentives to the Plans to offer competitive rates. Instead, vendors and broker-dealers are presented with the classic Hobson’s choice: doing business based on monopolist terms or not doing business at all. In this sub-competitive environment, valuable market data is sold to vendors and broker-dealers and then distributed to millions of retail and institutional investors, with these investors forced to pick up the tab for the

non-competitive pricing.

Without competitive forces to discipline markets, economic distortions result. No one really knows if market data fees are too high or low. What we do know is that they're not tied to value. More troubling is that innovation within the market for data provision is not rewarded. Exchanges have little incentive to bring innovative data products to market because prices are not a result of market forces, but "set," and the types of data that can be disseminated is regulated by the "Vendor Display Rule," a one size fits all mandate.

III. Hazing: NMS Style

As discussed above, the Archipelago Exchange is currently negotiating with the NMS Plans to, in essence, join the fraternity. Absent initiation, Archipelago cannot do business as an exchange. Ironically, the most difficult task about creating a new exchange isn't the enormous time and expense that goes into drafting 700 pages of rules filed with the SEC, or responding to public comment letters or regulators and clients about your market structure. No, the most difficult hurdle, or "barrier to entry" as economists say, is the hazing process that a new entrant must endure to join the NMS fraternity, which is composed exclusively of competitors. As with all frats, a single blackball veto right is part of the governing rules. A recent example: our staff was recently told by the staff of the NYSE that the Exchange's "interpretation" of the ITS Plan imposes severe limits on the ability of Plan participants to use computers to place orders into ITS the computer routing system that links the exchanges. The NYSE forcefully suggested that we change our market structure to include a time "probe," where the Archipelago Exchange would be compelled to delay accessing other markets before holding that order up for a pre-determined time – such as 15 or 30 seconds – so that a market maker can manually interact with the order.

We believe we do probe our market, but we do it electronically. Think of it in these terms: suppose American Airlines, through the authority of the FAA, informed United Airlines that it will no longer be in regulatory compliance if United's pilots use computer autopilot because American Airlines pilots choose not to use it. You're out of business, United, unless you do it American Airline's way. Can anyone name another industry where this type of never-ending "hell week initiation" is imposed as a precondition to joining?

With all due respect to the NYSE and their formidable business model, our view is that asking us to insert an artificial time probe is a bit like asking us to change our stripes to look more like them ... except without the 85% market share and the 208-year head start. We're not operating under the illusion that we'll put the NYSE out of business by relegating exchange flows to the Paleolithic Age. The truth be told is that if we grow to 10% of the market in IBM or T, it'll be Christmas in July.

IV. Our Market-Based Solutions

We respectfully suggest an overhaul to the current system where sunshine would be cast on "ancient fraternal rites" and competition would be injected to allow market forces to play a central role in the collection and dissemination of market data. Some observations and suggestions: First, competition among marketplaces must replace ratemaking by committee of competitors to provide value, and vendors must be allowed to pay for data based on that value. Instead of forcing vendors to contract with an NMS utility, let's allow vendors to contract with any number of marketplaces directly, and marketplaces sell data to vendors at prices that the market will bear.

Second, the types of data that a marketplace can sell to a vendor should not be regulated.

Rules that prevent or disincent a marketplace from providing value-added market data, such as full depth of book or analytic information, should have no place in securities regulation.

Third, while we are true believers of competition in the data market area, it may be prudent for a transitional period under which the NMS utilities would continue to function. These utilities can help ensure a “soft landing” as we move to a competitive model, so that consolidated information is not lost before new consolidators have the opportunity to build their business. Candidly, we expect that the NMS utilities “to wither on the vine” as more adept competitors enter the marketplace.

Finally, NMS Plan participants should be barred from using the “fraternity rules” as a license to affect the business model or value proposition of new entrants. Participants in such groups should be continually mindful that their mandate in no way includes determining the market structure of new exchanges. If necessary, the Plans should take action to change their governance to reduce the potential or conflicts of interest, whether unwitting or intentional. The SEC should be vigilant in protecting against the misuse of NMS Plans to deny investors innovative marketplaces.

Thank you. Archipelago looks forward to working with the Subcommittee throughout its review of the many changes occurring in today’s capital markets. I would be happy to answer your questions at the appropriate time.