Information is said to be the lifeblood of financial markets. Securities markets rely on corporate disclosures, quotes, prices, and indices, as well as the market structures, products and standards that give them context and meaning, for the efficient allocation of capital. The availability of and access to such information on reasonable terms has been identified as one of the essential characteristics of strong financial markets. And yet because information is a commodity, policymakers must balance the desirability of providing access to such public goods against the need to maintain appropriate incentives for information producers.

The Securities and Exchange Commission faces the primary challenge of regulating the balance between the commercial and social value of information in securities markets. In some areas, the Commission has all but extinguished private rights. In other areas, it has deferred to federal or state intellectual property doctrines. In yet other areas, the SEC has created intricate entitlements tailored to historical market structures. Against this backdrop, self-regulatory bodies, securities intermediaries, and other entities have staked out proprietary claims to position themselves competitively in the ongoing transformation of the securities marketplace.

Today, however, we are moving away from the paradigm of the dominant national exchange to the reality of competing national and global trading venues. The demutualization of the New York Stock Exchange and the Nasdaq Stock Market, as well as impending mergers of national and international exchanges, are likely to generate numerous disputes over the allocation of rights and interests in securities information. It is thus increasingly urgent that the Commission articulate some statement of policy to govern the Commission’s regulation of rights in information.

The SEC also regulates data regarding the negotiation and execution of secondary market transactions in publicly traded securities. Such “market information” includes buy and sell “quotations” as well as trade reports on completed transactions. Organized securities and commodity markets have long exerted significant effort to prevent “misappropriation” of their market data. Absent such protection, market-makers and other exchange competitors may “free ride” on an exchange's public market information to execute transactions at comparable prices at a lower charge.

Since 1975, the SEC has mandated public display, dissemination, and access to the best-priced quotations and customer orders held by any “market center.” For other classes of market information, exchanges and other market participants have pursued various legal and marketing strategies within the framework created by SEC rules.
Index providers have also sought to prevent misappropriation of the essence of their work product—the list of securities and indexing methodology used to compute index values. While indices have historically been compiled and published freely as “news,” the ability to peg options, futures, and derivatives to index values or index components over the past several decades has greatly increased their profitability. Older cases upheld the right of index providers to license their indices exclusively to a single options or futures exchange. In the context of new financial products, such as exchange traded funds, courts have denied index providers the right to prohibit resale of otherwise fungible products on different exchanges or in the over-the-counter market. The Commission, meanwhile, has refrained from regulating indices or their use, despite the anticompetitive impact of exclusive licensing, on the one hand, and the need to ensure adequate funding for index providers, on the other.

The ownership of the standards and protocols in securities markets has also received significant attention in recent years. In many areas, the Commission has preferred to retain standard-setting authority, or to delegate it to self-regulatory organizations over whom it has direct oversight and enforcement. In some cases, standards are owned by private organizations, such as accounting bodies; for such bodies, the Congress and the Commission have taken steps to assert some regulatory oversight while ensuring adequate funding through special levies on reporting companies.

**JUSTIFICATIONS FOR REGULATION**

In an efficient market, producers and users of securities information should arrive at arrangements that promote optimal use. Organized exchanges developed mechanisms for securities disclosure and market information long before federal regulation. Congress has nevertheless charged the SEC to balance the competing economic and noneconomic objectives in information law in the federal securities arena. Because of the SEC’s traditional self-identification as the “investor’s advocate,” securities regulations are generally advanced under the rubric of “investor confidence” or “investor protection.” The goals of economic efficiency and capital formation, where they appear in the federal securities laws, serve as decidedly secondary considerations.

The most widely invoked justification for regulating rights in securities information is the possibility of underproduction, or “unfair” selective disclosure or price discrimination. Here, the key problem that regulators confront is the metric by which to establish the minimum amount of information that should be disclosed. In the context of company
information, the Commission has required publicly held companies to disclose certain financial and nonfinancial information periodically as well as to ensure that “material” information is not selectively disclosed (such as in the context of insider trading). The SEC has also adopted rules requiring public disclosure of certain tiers of market information, although it has permitted certain markets to charge for such information in order to fund their regulatory activities.

The Commission has also focused efforts on improving the quality, integrity, and accuracy of various types of information. When minimum standards of quality assurance are set by the SEC, the parties’ traditional cost/benefit analysis is supplanted. Recent controversies over the Sarbanes-Oxley Act’s disclosure control reporting requirements illustrate the difficulties inherent in determining the cost-effectiveness of disclosure when the information generated has no tangible commercial value and cannot be subjected to a ready cost/benefit analysis. The same problem recurs for other types of information where the granularity of information may outweigh its usefulness, such as the increments in which quotations or trade reports are published. Such information, once released, may also trigger unpredictable liability under the Commission’s far-reaching antifraud rules.

The Commission’s information policy also plays a significant role in how markets are structured, how market supervision is financed, and how closely the Commission is able to supervise the evolution of market standards. In such contexts, the regulation of intellectual property rights is one tool in the Commission’s larger arsenal for balancing competition and coordination in securities markets: To the extent that the offering and trading of securities requires coordination among market participants, Congress has impliedly provided limited exemptions from the federal antitrust laws while conferring limited authority upon the Commission to supervise and, when necessary intervene, on an ongoing basis in those arrangements. Because the Commission lacks the powers of other economic regulators, the ability to modify intellectual property rights in various types of securities information can provide a useful tool for promoting or dampening competition as circumstances warrant.

**STRATEGIES FOR REGULATORY INTERVENTION**

Such intervention is of course susceptible to numerous pitfalls. Lack of Commission expertise or resources, regulatory capture by stock exchanges and other self-regulatory organizations, deference to industry representatives in the absence of organized investor advocacy, and bureaucratic process and nonresponsiveness have all been cited as harbingers of potentially damaging regulatory failures. The lack of clear legislative guidance complicates the agency’s perspective, as the implementation of investor protection goals may appear inconsistent across unrelated rulemaking exercises.

The Commission’s most straightforward strategy for addressing the conflict between federal or state law property rights and regulatory objectives under the federal securities laws is preemption. Federal securities law contains extensive examples of preemption, largely to limit the impact of duplicative or inconsistent state regulation in the “national” market system. Preemption of state or federal intellectual property rights, as a strategy for achieving other regulatory objectives, lacks nuance. For example, the Commission argued that no conflict of interest exists between protecting the commercial value of indices by charging licensing fees for their use and the Congressional objective of permitting unlisted trading of listed securities by competing exchanges; it has simultaneously asserted the right to preempt state rights in information even in situations where such rights could be reconciled with its rulemaking objectives.

The Commission has also sought to create compulsory licensing regimes, through various enforcement mechanisms, settlement decrees or by judicial order. For wholesale market data transactions, the Commission has justified rate-setting exercises based on its statutory authority to approve the reasonableness of rates charged by self-regulatory organizations and to oversee the “national market system.” Because neither statutory mandate expressly confers authority to engage in ratemaking by any statutory metric (such as on a “cost-plus” basis), Commission “ratemaking” has historically been driven by negotiation among self-regulatory organizations (to the exclusion of other market participants) in the shadow of the Commission’s authority. The Commission has also experimented with formulas to allocate certain market data revenues among market participants based on the judgments about the quality of various categories of information.

More recently, the Commission has experimented with the regulation of selective disclosure of information under the rubric of “fair and reasonable” or “nondiscriminatory” access. Under such approaches, regulators would not oversee the rate-setting process but would be entitled to intervene in any denial of licenses to individual market participants on the basis of unfairly discriminatory criteria. Defining how the concept of “fair access” should apply in highly intermediated markets is problematic. When intermediation is not required for investor protection purposes, the question of fair access reduces to whether the creator of the information should be subject to a “duty to deal” with all potential end-users. When intermediation
is deemed necessary, such as to promote consolidation of market data, Commission policy must ensure that mandatory intermediation does not lead to abuses of market power.

**A Regulatory Agenda**

While there is no “grand unified theory” of securities regulation, critics of the SEC frequently lament the agency’s failure to articulate principles for securities disclosure and regulation. Many of the Commission’s deregulatory efforts have been modest in ambition, such as reforms of the public offering process and the dismantling of the more anticompetitive exchange rules held over from before the federal securities laws. At the same time, the Commission is aware that greater deregulation will be necessary as a result of structural changes. The demutualization and globalization of stock exchanges suggest that it may be easier to export rules grounded in universal norms of ownership and authorial integrity, rather than a set of regulations geared exclusively to a single set of market institutions. Where possible, the Commission should thus consider greater reliance upon private incentives, while using rule-making judiciously to address situations in which traditional conflicts of interest or fraud come into place.

First, the Commission should acknowledge that the rights of information owners under state law are not preempted except as expressly provided by statute or Commission regulations. The Commission’s mixed signals as to the proprietary rights of creators have led market participants to argue, as in Archipelago, that the preemptive scope of the federal securities laws reach further. Clarifying that Commission rules derogate from such common law rights, rather than supplant them, is a first step toward creating appropriate incentives for market participants. Where proprietary claims under state law are in doubt—such as for indices—the Commission might use its regulatory authority to provide greater protection.

Second, the Commission should permit selective licensing or disclosure in a broader range of circumstances. Permitting creators of information to provide selective access to creator-defined categories, subject to Commission review, may be one way to address this issue. Where certain categories of information contribute to the formation of “downstream” information (such as the contribution of company information to market prices or the contribution of market prices to index prices), the Commission should consider when intervention is necessary to manage the flow of information. More generally, the Commission should reconsider the respective roles of securities and antitrust law in policing access—particularly in areas where it is debatable whether ex ante Commission rulemaking or rule approvals are clearly superior to ex post antitrust enforcement.

Third, the Commission should also endeavor to encourage licensing or disclosure of information though negotiated bargaining. The licensing of market information, for example, is likely to take place among a relatively well informed community of market participants and is therefore an ideal candidate for a bargaining framework. Standard-setting organizations may also be used as a proxy for end-users when bargaining costs with principal consumers would be excessive. Bargaining may, as today, be backstopped by the Commission’s enforcement power or by default rules, as discussed further below.

Finally, the Commission should encourage the development of substitute goods by reconsidering regulations or regulatory policies that inhibit investor choice. At a minimum, rules that refer to particular information products must be revised to permit uses of all comparable products. In the area of indices and product design, greater opportunities for substitute goods may be created by relaxing rules that require specific offsetting of products, such as for minimum net capital requirements for broker-dealers and margining of customer accounts.

**Conclusion**

The Commission’s role in regulating information is one that has arguably been thrust upon it with little legislative guidance and buffeted with considerable political pressure over the past seven decades. Yet the Commission has dutifully explored ways to balance the interests of producers and consumers of information that will result in more efficient markets. A core statement of principles—such as those suggested herein—together with concrete efforts to experiment and to collaborate with emerging market participants, may go a long way toward clarifying expectations and encouraging the development of new information products.

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