RESPONSE OF COPENHAGEN ECONOMICS TO THE REPORT:

“THE DESIGN OF EQUITY TRADING MARKETS IN EUROPE”

COMMISIONNED BY THE DANISH SECURITY DEALERS ASSOCIATION
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The provision of market data is an increasingly debated topic both within the industry and among policy makers. In autumn 2018, Copenhagen Economics published the report “*Pricing of market data*”, commissioned by the Danish and Swedish Security Dealers Associations. In short, the report finds that market data costs are rapidly increasing and give rise to less transparent and efficient financial markets.

In the spring 2019, Oxera published the report “*The design of equity trading markets in Europe*”, commissioned by the Federation of European Securities Exchanges (FESE). The report addresses many of the same topics as the Copenhagen Economics report. In this memo, we briefly provide our five main comments to the report from Oxera.

1 WE AGREE WITH OXERA ON THE IMPORTANCE OF MARKET DATA

A recurring topic in the Oxera report is documenting the value of transparent trading and informed markets. For example, Oxera writes that “*Transparent trading on stock exchanges plays a central role in price formation, which contributes to fairer and more efficient markets and lower costs of capital for European businesses*”.

We could not agree more. In fact – in line with the Oxera report – Copenhagen Economics (2018) argues that transparent trading and informed markets have a range of benefits for market efficiency and end-investors.

An obvious way to increase market transparency is to ensure widespread availability of market data through easy and low-cost access. This is very much in contrast to the situation today, where banks and security dealers are limiting their access to market data due to high costs, as documented in Copenhagen Economics (2018).

Thus, to ensure the benefits of transparent trading as the Oxera report highlights, regulators need to curb the high and increasing market data costs.

2 COSTS INCREASES ARE PRIMARILY DRIVEN BY NEW FEES AND RIGID AUDITING PROCESS

The Oxera report illustrates price development for three different market data fees since 2012. Oxera argues that the price increases have been modest and conclude that there are no signs of increasing costs for market data. In contrast, Copenhagen Economics (2018) finds that market data costs have increased by 30%-60% since 2008, based on a case of a small Nordic investment bank[1].

We have identified three factors that can explain the differences between the results in the Oxera report and in Copenhagen Economics (2018):

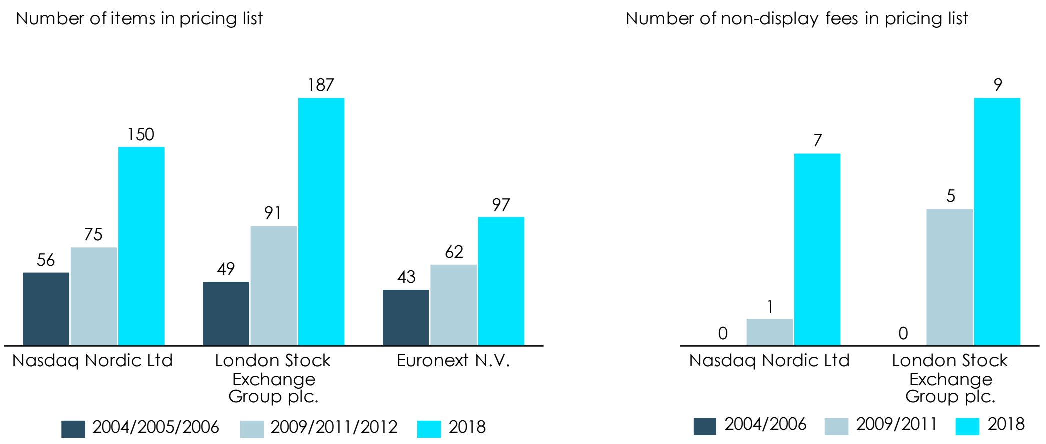
First, and most importantly, the main cost driver for market data users is not so much increases in already *existing* fees. It has been the introduction of *new* fees related to multiple display-terminal, non-display applications, reporting and distribution licences – in combination with unclear and complex market data policies and definitions that can be used in favour of the trading venues. Since 2007, the number of fees has more than doubled at Euronext, and almost tripled at LSE, *cf. Figure 1 below*. Especially non-display licences have been costly as non-display data is used in all stages of the value chain of security dealers, from research to trading, middle- and back-office applications.

Second, the three fees shown in the report constitute a small share of all the fees that affect market data costs. For example, LSE has close to 200 different fees in their latest price list. Thus, the development in three fees is a poor indicator of the overall development in market data costs, cf. Figure 1 to the left.

Finally, only going back to 2012 is a too narrow time period to illustrate the issues. As the Oxera report highlights, it was MiFID I, introduced in 2007, that changed the competitive dynamics on the trading venue market. And it was these new competitive dynamics which accelerated market data fees. Showing the fee development from 2007-2017 reveals a much larger increase in market data prices.

[1] 20 traders, 20 in sales and 10 analysts

Figure 1
Number of different fees in the fee schedule

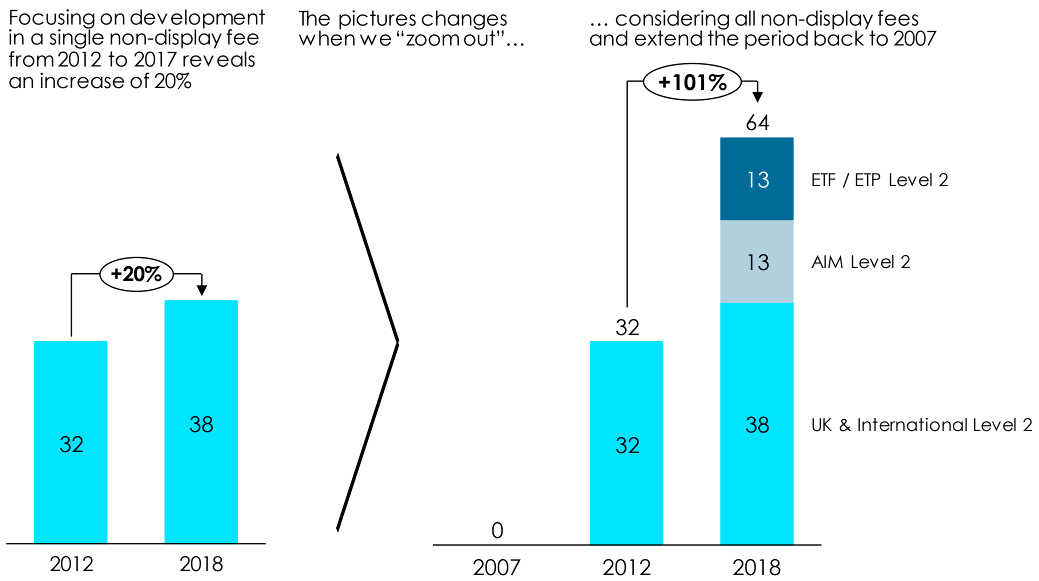


Note: Notice different starting year. London Stock Exchange Group Plc. has different fees for different customer groups. The number of non-display fees shows the number of fees for Tier 1 customers. Data was not available for all trading venues.

Source: Prices lists from trading venues

The points above are illustrated in *figure 2 b*elow. To the left, we see the development in the 'standard' level 2 non-display fee from 2012-2018 – in line with what is shown in the Oxera report. This reveals a price increase of some 20% (in nominal terms). When we 'zoom out' and consider all types of non-display fees, we find that costs have doubled from 2012-2018.

Figure 2
Development in non-display fees at London Stock Exchange
1,000 EUR per year



Note: Oxera does not write exactly which non-display fee they depict for LSE in figure 4.11, but it looks like the Tier 2, enterprise, member price for "combined UK market data Level 2 & International market data Level 2", as depicted above. Numbers are rounded, not deflated and based on exchange rates at the time of writing.
Source: Price lists from LSE

3 NO COMPETITIVE PRESSURE TO ENSURE REASONABLE PRICED MARKET DATA

A central argument in the Oxera report is that trading venues have an incentive to ensure reasonable prices on market data, because this will increase the order flow. For example, "*The core business model is to maximise order flow, by attracting traders to provide liquidity. Prospective investors seek venues that provide both access to reliable market data and low trade execution fees. Thus, there is competitive pressure on stock exchanges to ensure that the pricing of their services – for both market data and trade execution – should incentivise market participants to trade on their exchange.*"

We disagree. The trading venues have a clear incentive to increase fees to increase profits. Especially since security dealers' demand for market data from the big trading venues is very inelastic to price changes, as security dealers are required by MiFID II/MiFIR to obtain market data from the major trading venues in order to document 'best execution'. For example, if a security dealer bought shares on behalf of a customer, the dealer should be able to document that the customer acquired the shares according to a best-execution policy – this can only be done by having access to market data from the main trading venues where the shares are traded.

Indeed, as underlined in the Oxera report: *"the primary exchanges are still driving the majority of the price formation"*[2]. In other words, while new smaller trading venues have captured some of the trading activities, getting access to market data from the dominant primary exchanges is essential to provide best execution. In conclusion: there is little – if any – correlation between the pricing of market data and the choice of venue.

Oxera also points out that: *"A stock exchange will evaluate the profits it receives from both market data and trading services and seek to set prices that maximise its overall profits."* As described in Copenhagen Economics (2018) and in related academic papers, in doing so, it can be a good strategy for a for-profit trading venue to price trade execution at a low level to maximise order flow, which can give a leading position within a certain security segment. Market participants will then be obliged – by regulation – to buy market data from the trading venue, which hereby can be sold at a high price. So, in essence, the causality is the other way around: selling market data at a higher price allows the primary exchange – all other things equal – to lower trading fees.[3]

4 INCREMENTAL COSTS IS THE RIGHT MEASURE

The Oxera report thoroughly outlines the functioning of trading venues and that market data is generated as a natural consequence of the price formation process. This is in line with the Oxera report from 2014, where it is argued that "*Market data is a by-product of the overall operation of the trading system*", and "*it is not possible to provide transaction services without generating market data*". This is an assertion that we share.

As market data is a monopolised by-product, we suggest that market data should be capped at the incremental costs of producing and disseminating the already generated data. This follows how sectors with similar market situations are regulated, as documented in Copenhagen Economics (2018). The US trading venue IEX provides a concrete example on how to calculate this in their report "*The Cost Of Exchange Services*". Concretely, they find that most US trading venues price their market data in the range 4x-18x higher than the cost of offering the data.

5 MARKET DATA COSTS AS A SHARE OF TOTAL MARKET CAPITALISATION IS NOT A FAIR MEASURE

Oxera argues that the current pricing of market data is likely to have only an insignificant impact on investors because market data costs are very small relative to total market capitalisation or total trade turnover (Tables 4.2 and 4.3). The latter is indeed correct – but the same could be said about any other cost in trade execution. With that argumentation, there is no need to aim at making trade execution more cost-efficient; any costs look small when compared to total market capitalisation. The argument seems also at odds with other parts of the Oxera report that underlines the benefits to final consumers and investors of having a deeply liquid market for securities with efficient price formation.

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2 Page 54, section 3.6

3 This could in turn be an obstacle for smaller venues, which cannot retrieve large earnings from market data, cf. CE (2018), chapter 4.

Thus, the argument is missing the point. The real issue is that highly priced market data make market participants scale back on their access to and use of market data. This gives rise to less transparent, informed and therefore less efficient markets, eventually increasing risks for end-investors and providing higher cost of capital for European businesses.