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Ms Teresa RODRÍGUEZ ARIAS
International Organization of Securities Commissions (IOSCO)
Calle Oquendo 12
28006 Madrid
Spain

Re: Public Comment on the Consultation Report: “Regulatory Issues Raised by Changes in Market Structure”

Dear Ms Rodríguez Arias,

Thank you for giving us the opportunity to comment on your Consultation Report CR03/13. Our company Rights Management Associates Ltd is a specialist consultancy focused on the use, licensing and regulation of market data. Our clients include exchanges, alternative trading venues, market participants, data vendors, index providers, trading technology providers and industry associations. We aim to serve the common industry goal of the widest legitimate use of market data, at the lowest overhead cost, with a minimum of administrative burden.

Comment Summary

In March this year IOSCO Secretary-General Mr. David Wright observed during his keynote speech to the World Exchange Congress in London that regulators had at best a highly imperfect understanding of the way in which financial markets relate to each other.

We respectfully submit that the use and processing of real-time market data and the licensing of market data usage rights play key roles in the creation, connection and structuring of markets in our global trading environment. The ability of today's market data processing technology to connect markets across national barriers and asset classes is at least as important in its impact on market structure as any high-frequency-trading capability.

The Consultation Report deals with market data issues almost entirely in terms of fragmentation and consolidation of market data by individual asset class and individual regulatory jurisdiction. We suggest that in today's trading environment this approach can lead at best to a highly fragmented and inefficient approach to securities regulation, at worst to unintended consequences and risk to the markets most directly affected.

Today's increased focus on evidence-based benchmarks¹ also highlights the need for careful consideration of how market data is used and regulated. Some of today's most widely used evidence-based benchmarks are proprietary indices calculated in real-time from the real-time proprietary market data of third party contributors. Contractual rights to calculate, use and license these indices have enormous commercial significance. They also play a crucial role in the development and operations of markets across geographical and regulatory boundaries, as can be seen from any study of venues and volumes for the trading of financial products benchmarked to emerging markets equities data.

Our research and experience lead us to the view that securities regulation needs to move beyond long-established concepts of fragmentation in individual markets and localized mechanistic interventions such as the construction of consolidated tapes per asset class and regulatory jurisdiction. A clearer focus on the interconnectivity of markets and the availability and licensing of specific market data usage rights (as opposed to market data delivery solutions) could help ensure that frameworks for securities regulation around the world are globally applicable, cost-effective, sustainable and compatible with wider and occasionally divergent economic, social and political aims for the development of capital markets around the world.

In a world of interconnected markets we also suggest that obligations to demonstrate “best” execution by asset class may not justify their very considerable cost of implementation. Principles of fair competition

¹ See IOSCO Consultation Report “Principles for Financial Benchmarks” <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD409.pdf>, in particular Appendix B

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among venues and market participants, consumer protection and fiduciary duty in respect of financial institutions dealing with private investors may be more practical and cost-effective.

This less mechanistic approach could also enable regulators to facilitate industry solutions to regulatory aims more successfully, with less risk of distorting market structure.

General Comments

In today's global trading environment, price-forming market data from an equities exchange may be used to:

- support trading of the same instruments on other venues,
- calculate benchmarks and indices (whether or not published) to support trading of derivatives and funds on other venues and in other regulatory jurisdictions,
- form the basis for "trading substitute" activities such as spread betting.

Whether or not the data from any particular exchange is used in this way depends on the terms of various licensing agreements between the exchange and data recipients. These terms can have a very significant impact on market structure, at both national and global level. For example:

- Exchanges in China and Brazil have for many years maintained strict control over the rights of equities data recipients to create indices and use them as the basis for pricing financial instruments. We see it as no coincidence that these countries have also succeeded in developing very substantial markets for index derivatives.
- Most other emerging market country exchanges entered license agreements with market data vendors which did not restrict the right of the data vendors' customers to create and license indices from the price-forming exchanges' data. As a result the vast majority of financial products based on emerging markets assets are issued, regulated and traded outside the country of the price-forming exchange. We also note that very few of these countries have succeeded in developing globally competitive markets in index funds or derivatives.
- Many developed markets exchanges and alternative trading venues charge fees for the right to use their data for the purpose of creating indices and pricing financial products. If more emerging markets exchanges follow the example either of China and Brazil in restricting index creation rights or of developed market exchanges in charging substantial fees for these rights, there could be very significant changes to the location and cost basis of trading in emerging markets index products and derivatives.
- The current debate relating to evidence-based benchmarks will need to consider the implications of rights and obligations to use proprietary transactions data to create benchmarks. As the above examples indicate, the contractual rights to use proprietary real-time market data for calculation and licensing of benchmarks can have enormous commercial value and very significant impact on market structure.

In this context we suggest that the Consultation Report's focus on the structure of markets in individual asset classes in individual regulatory jurisdictions may fail to address the challenges of a global trading environment. In addition terms commonly used in regulatory debates may need to be considered more closely. In particular:

- **Market Transparency**

Market Transparency is used by reference to a report of the IOSCO Technical Committee in November 2001 which defines the term as

"the widespread availability of information relating to current opportunities to trade and recently completed trades"

The Consultation Report seeks to extend the 2001 findings to exchange-traded funds (ETF) but not to derivatives. Yet in today's environment the relationship between equity prices and the prices of a wide range of alternative instruments plays a key role in investment decisions and risk management – at least for market participants and institutional investors. Private investors will not normally have the same access to this level of data.

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Market data is commonly referred to via a type of shorthand as transparency information, yet in practice:

- i.) The vast bulk of pre-trade and post-trade equities data is made available to the computer systems of market participants but is never displayed to private investors. ii) Knowing the price for an equity on all venues where it is traded does not, by itself, provide the investor with sufficient information about opportunities to trade. Market participants and institutional investors generally have access to real-time data for the proprietary benchmarks and indices calculated from equities data and used to price other financial products. They may also have systems to compare prices for “derived data” products such as futures, options and contracts for difference (CFD) with prices for the underlying securities. Private investors generally do not have access to this information in time to reveal and take advantage of opportunities to trade.

In this context the consolidation and publication to the private investor of market data from different venues for the same instrument arguably provides only a semblance of transparency, rather than any reliable consumer protection.

- **Market Fragmentation**

Market Fragmentation is defined, following the same 2001 report, as:

“the existence of multiple market centres (exchange markets, over the counter (OTC) market makers and Alternative Trading Systems (ATS)), through which the same securities are bought and sold.”

This definition pre-dates the widespread use and processing of real-time market data to support trading across asset classes. In addition the Consultation Report considers market fragmentation almost exclusively in terms of market centres within a single regulatory jurisdiction, when it is clear that the market data of price-forming exchanges (especially those in emerging market economies) are increasingly used to support trading in various alternative asset classes outside the regulatory jurisdiction in which the source exchange operates.

In today’s interconnected markets we believe that this 1970s concept of market fragmentation is both outdated and increasingly dangerous, given its potential for generating substantial but ineffective fragments of regulation.

We suggest IOSCO members consider a radically different and more positive approach to the same issues, by considering them and applying IOSCO’s Objectives and Principles of Securities Regulation² in terms of *connectivity* between venues and markets, rather than the fragmentation of what might otherwise (in theory) be a single market for a single asset class under the auspices of a single regulator.

- **Investor**

The Consultation Report uses the term “investor” to apply to any individual or institutional purchaser of a given security. Investors may include global trading firms, market participants and private individuals managing their own private investments. For price-forming exchanges the “investors” to whom market data is made available may include the direct competitors of the exchange and/or the owners, sponsors and suppliers of these competitors.

Regulatory interventions relating to the publication of market data to the public cannot be specified with any degree of precision using this very general sense of the word “investor”. Private investors cannot physically handle the millions of market data updates sent to market participants and should not be expected to pay for the facilities required to do so. Price-forming exchanges cannot be expected to make data available on the same terms (a) to a private investor using the data to manage his/her own private investments, (b) to a global organisation using the same data to establish a trading venue in direct competition to the price-forming exchange, and/or (c) to a third party which processes the data in real-time to support alternative forms of investment activity such as CFD trading.

² See <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD323.pdf>

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Use of broad terms such as “investor” combined with failure to focus on market data usage rights may also create unnecessary confusion relating to the cost of market data. It is commonly claimed that the high cost of some exchange market data fees for market participants and institutions may restrict the availability of real-time market data to “investors”.

In practice the cost of market data to the retail investor bears little or no relation to the market data fees that may be paid by professional institutions - or to the market data fee waivers and discounts that many exchanges offer to market participants.

Market data is not “sold” in the sense that ownership passes from the source via intermediaries to any end user. Instead, exchanges and other market data sources charge fees under data licensing agreements for rights to use market data. Since the 1980s, when the SEC approved terms for access by non-professional subscribers to US equities data, different market data usage rights have been carefully specified in order to ensure that real-time data is available for non-commercial use by private investors at far lower fees than apply to use of exactly the same data by institutions for commercial purposes.

In today’s global trading environment market data is increasingly made available and licensed for commercial processing by market participants, index calculators and other institutions in ways that have nothing to do with making the source market “transparent” to private investors. Fees charged for these commercial data usage rights normally have very directly to do with the cost of the underlying market data for use by private investors.

In this context, it is our view that any regulatory intervention in market data terms and conditions intended to serve the interests of private investors would need to be very precisely specified in order to avoid unintended consequences in areas that may fall outside the aims and/or remit of the securities regulator.

- **Consolidated Market Data**

The Consultation Report uses “consolidated market data” to refer to the consolidation of data from all regulated venues covered by the same regulatory regime in which an individual security is traded. The Report states³:

“the consolidation of information across trading spaces is recognized as important in a fragmented environment. The degree to which relevant information is available and consolidated is dependent on the market structure of each C2 member jurisdiction.”

In today’s global trading environment market structures transcend asset classes and regulatory jurisdictions, but the Consultation Report does not address the issue of data consolidation among jurisdictions and consolidation of data on various assets priced by reference to the same underlying data.

As a result:

- i) Any consolidation of market data within individual markets and asset classes may fail to provide a comprehensive and transparent presentation of relevant data to the investor who wishes to choose between trading individual equities in his own market, the same equities traded in other regulatory jurisdictions and index products or CFDs purporting to cover the same underlying assets.
- ii) Regulatory intervention to facilitate or mandate the consolidation of data within asset classes and regulatory jurisdictions may as easily distort as protect or encourage market structures. In particular, intervention to mandate the global availability of and unrestricted commercial usage rights to proprietary market data (including evidence-based benchmarks) may distort fair competition in developed markets and inhibit the ability of emerging market economies to develop internationally competitive domestic capital markets.

³ 3.4(c), page 16.

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Regulation on any global scale via the mechanistic consolidation of market data also raises complex questions of extraterritoriality and regulatory priorities. For example, faced with the relationship between markets for locally traded equities and overseas-traded ETFs and index derivatives, the capital markets authority of an emerging market economy may have a different set of priorities from the equities market regulator of a developed economy with a booming international ETF market.

From a global perspective, the limitations of mandatory market data consolidation as a regulatory tool can be stated in much simpler terms. If the consolidate tape is seen as a default answer to fragmentation of markets, how many consolidated data tapes are needed to serve the global trading community, who should set the terms on which consolidated data tapes are made available to the public and how often would a global framework of consolidated tapes need to be updated?

- **Best Execution**

The Consultation Report's summary of the current status of regulation relating to "best execution" makes two key points:

"The concept of "best execution" has been defined in similar, but distinct ways in almost all G2 member jurisdictions."

"...for those jurisdictions where several trading spaces are permitted by law, specific rules have been implemented that seek to limit the potentially negative impact of fragmentation, like "best execution" and "trade through" rules, *although these rules have often predated the evolving fragmentation of markets over the last decade.*" (emphasis added by RMA).

As suggested above, we believe it is time for regulators to approach market structure from the practical perspective of interconnected markets and venues, rather than the theoretical perspective of single but increasingly fragmented markets per asset class and regulatory jurisdiction. We suggest that if the regulatory concept of best execution is to remain relevant it would need to evolve in the same direction, as automated trading technology has already evolved in practice, to address for any trading decision the issue of what to trade as well as where to trade.

Failure to adapt regulatory principles to the reality of interconnected markets could have significant adverse consequences. There is a risk of "similar but distinct" "specific rules" and costly mechanisms such as mandatory consolidated tapes proliferating around the world by regulatory jurisdiction. Costs of implementation across asset classes for any "best execution" regime would be substantial; costs of maintaining and complying with the new regimes would inevitably spiral and each individual best execution regime would in practice cover an ever-decreasing proportion of the investment opportunities available to market participants and private investors it seeks to protect.

What are the alternatives? We can claim no expertise in this field but from our observation of other industries and our experience as consumers we suggest that (i) the interests of institutional market participants and trading venues may be better served via principles of free and fair competition and (ii) the interests of private investors may be better served by principles of consumer protection and obligations of fiduciary duty for organizations providing financial services to private investors.

In many national and international jurisdictions fair competition and consumer protection are already covered by well-established legal and regulatory regimes. The approach we suggest may therefore be a means of limiting and/or reducing an unnecessary burden on the scarce resources of securities regulators.

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Comment and response to Consultation Report questions

“Recommendation 2

In an environment where trading is fragmented across multiple trading spaces, regulators should seek to ensure that proper arrangements are in place in order to facilitate the consolidation and dissemination of information as close to real time as it is technically possible and reasonable.”

Questions:

2. What conditions, if any, should govern access by investors to consolidated market data?

In a global trading environment any regulatory involvement in market data licensing should take account of the potential impact on other markets, including markets in other regulatory jurisdictions.

In practice this may require detailed focus on clearly specified market data usage rights and far more rigorous economic impact analysis than has featured in consultations to date⁴. To put it plainly, access to data is governed by data usage rights, hence data licensing is part and parcel of transparency; regulations mandating and/or restricting specific data usage rights can be far more effective than blanket rules over delivery of data in achieving regulatory objectives and avoiding unintended consequences such as distortion of market structure.

For example, any regulatory conditions governing market data distribution and licensing that are aimed at protecting the interests of the private investor should be limited to the terms under which individual private investors have access to market data solely for their own personal use and not for any distribution or other commercial use.

In some parts of the world, proposed intervention by securities regulators appears to be driven by aims to increase competition or address perceptions of excessive fees charged to market participants and other organisations for their commercial use and processing of market data. We question whether national and regional securities market regulators are best placed to act as competition and fair trade authorities in today's global markets.

In summary, in a global trading environment individual regulators may not be in a position to specify what data need be consolidated with what other data in order to provide “transparency” on reasonable financial terms to various classes of investors, protect the integrity of capital markets, etc.

Any such “mechanistic approach” will run the risk of:

- (a) creating a series of incomplete regulatory constructs, each delivering the semblance but not the reality of what the investor needs to make investing decisions, and/or
- (b) distorting market structure if it forces the investor to access/pay for information she/he cannot use (such as out of the money options.....) and denies the investor access to information that might reasonably lead to a decision to trade via another asset class or in another regulatory jurisdiction.

Instead, we would suggest that securities regulators should think less about specific data delivery mechanisms or combinations of data to be consolidated and more closely about the need for venues and markets to make market data available *and to specify which data usage rights need to be made available on fair and reasonable terms.*

⁴ For further background see our white paper “Market Data Licensing and Regulation in a Global Trading Environment” <http://www.rightsmgt.com/>

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3. Are there other challenges (technical, regulatory, prohibitively high costs) with regard to creating and/or accessing consolidated market data? What if anything, should be done to address these challenges?

For reasons given above, in a global trading environment trading decisions for both institutional and private investors will depend on different combinations of data from various markets and from regulated and unregulated sources around the world. Under these circumstances, we believe local securities regulators can and should take steps to ensure that high quality data from the markets they regulate is made available to market participants and to the private investors they serve. We do not believe the regulators are best placed to ensure (via data consolidation or other means) that all items of data deemed necessary for any given trading decision by any private investor are indeed supplied to that investor.

“Recommendation 5:

Market authorities should monitor for novel forms or variations of market abuse that may arise as a result of technological developments and take action as necessary. They should also review their arrangements (including cross-border information sharing arrangements) and capabilities for the continuous monitoring of trading (including transactions, orders entered or orders cancelled) to help ensure that they remain effective.”

Questions:

2. Are there any other issues associated with the fragmentation of markets that have not been mentioned in the current report?

To summarise the points raised in this letter, we believe the following issues are relevant to changes in market structure and should be taken into account by regulators:

- Regulatory thinking needs to move beyond outdated and over-simplistic considerations of fragmentation and consolidation of data content by asset class and regulatory jurisdiction. As a first step we suggest the issues covered in the Consultation Paper should be approached from the perspective of market and venue interconnectivity, in which market participants and investors have far wider choices than the selection of trading venue for a particular asset and concepts such as transparency and best execution cannot necessarily be served by any single consolidation of market data.
- The use and licensing of real-time market data play a key role in connecting markets and providing access to information. Regulatory intervention in the publication of market data and associated commercial terms may therefore have substantial impact on market structures, both inside and outside the jurisdiction of the regulator(s) responsible for the intervention.
- Any regulatory initiatives that mandate the availability and/or cost of market data need to be carefully considered and clearly defined in terms of specific market data usage rights.
- Regulatory interventions relating to the way market data is made available to the public should be defined in terms of private investor data usage rights.
- Regulatory interventions affecting commercial market data usage rights (including rights to create and license benchmarks) should be subject to more rigorous impact analysis, taking account of cost-effectiveness, the risk of unintended distortion of markets in other jurisdictions and compliance with existing frameworks for regulating trade and competition.

Concluding comments

Our research and experience suggest that IOSCO's Objectives and Principles of Securities Regulation can provide an adequate and appropriate framework for regulators to address the issues we have identified above from the perspective of market and venue connectivity. However any such approach would require a deeper understanding of the role of market data usage and market data licensing in connecting markets and venues.

Within this framework individual regulators are likely to have very different priorities. For example the capital markets authority of an emerging market economy could reasonably be expected to place a higher priority on the development of local ETF and derivatives markets than on the consolidation of its equities

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market data with that of overseas venues trading the same instrument. Different countries are also likely to have different concerns about the use of real-time data to support offshore CFD trading or spread betting operations. Local variations (which could involve anything from an emerging market regulator's control over index creation rights to the SEC's NMS trading rules) would be adapted to fit within the standard framework.

In our view these various concerns and priorities cannot be addressed on a global scale via rules for the mechanistic consolidation and delivery of market data. We suggest a greater focus on the availability of market data and on the licensing of specific data usage rights, together with wider use of established legal frameworks to support free and fair competition and provide consumer protection. In our view this approach could limit an otherwise inevitable increase in the cost and complexity of securities regulation and minimize the risk of unintended distortion of market structures. For further background, please see our white paper "Market Data Licensing and Regulation in a Global Trading Environment"⁵.

Reg Pritchard, Susan Gallagher

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⁵ <http://www.rightsmgt.com/>