The Road to Reasonable Commercial Terms for the European Consolidated Tape

ESMA's recently published Consultation Paper (CP) on MiFID II/MiFIR raises three options for ensuring consolidated tape market data is made available on reasonable commercial terms:

- transparency in publishing market data fees,
- relating fees to cost,
- limiting market data services income as a percentage of a venue's overall income.

It also suggests mandating fees per user as a means to reduce costs and complexity.

In this white paper, based on articles published via www.tabbforum.com[1], we outline the difficulties underlying the approaches suggested by ESMA's CP and suggest an alternative way forward which we believe would bring wider long-term benefits for the use, licensing and regulation of market data in a global trading environment.

A) Approaches suggested by the ESMA CP

1) Transparency in publishing market data fees.

Anyone who's tried to gain an understanding of market data fees from published price lists very rapidly hits four big problems.

i) There are hundreds of possible fees. Many of them apply in combinations, for example annual plus monthly fees.

ii) Fees for anything complicated are often not specified – which usually means negotiating additional agreements, terms and discounts.

iii) Use of market data for trading purposes (which is after all the main subject of MiFID II/MiFIR) may not even be covered by market data agreements. In some cases it may be available free of charge under membership or trading agreements.

iv) The overall amount paid in market data fees can depend as much on fee policies governing unit of count, reporting obligations etc as on the list price. Fee policies and practice are notoriously complicated and are not necessarily specified in contracts.

Even if ESMA can specify what must be published, it's by no means clear that transparency alone can identify and bring enough pressure to bear on unreasonable fees.

2) Relating fees to cost

Entrenched arguments for and against cost-based market data fees have kept lawyers, lobbyists and their consultants prospering since the 1980s. Examples are easy enough to find on the SEC website. ESMA's CP references two papers, from Oxera (for some exchanges) and from Copenhagen Economics (for some market participants) that sit squarely in this tradition. It also refers to an EU Commission finding on time-based fees for access to mobile phone networks.

These arguments have established their own territory, language and dogma over the years. For example they take as a given that exchange market data fees apply to the supply and sale of the data either direct or via data vendors and to the purchase and consumption of data by its "end user" recipient. In fact, neither of these assumptions is true. The use and licensing of market data has moved on since the trenches of this battlefield took shape thirty years ago.

Market data is not "sold", "purchased" or "consumed". Market data fees are licence fees for the customer's rights to use data. They apply regardless of how the data is supplied - in some cases whether or not the customer actually receives or uses the data.

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[1] See http://www.tabbforum.com/opinions/the-road-to-reasonable-commercial-terms-for-the-european-consolidated-tape-part-1 and http://www.tabbforum.com/opinions/the-road-to-reasonable-commercial-terms-for-the-european-consolidated-tape-part-2

The link between cost and whether market data fees are reasonable is therefore far more tenuous than the traditional arguments assume. The cost of establishing a fee for the right to create indices or to use equities data to price derivatives might be no more than an hour or two to draft a contract amendment plus notification, negotiation and administration time. Costs of data licensing are excessive because of the monstrous data contract and administration structure, but these costs have little or nothing to do with the aggregation or delivery of a market data feed or the provision of trading connectivity to the recipient.

Other forms of content licensing and regulation show how far the market data industry and its regulators have remained in a world of their own. No regulator tries to protect the public interest by limiting the fee for TV rights to the cost of covering the event. Public service broadcast regulation does not prevent the efficient global licensing of commercial TV rights. Every author is a monopoly supplier of his work, but no-one links performance rights to the cost of writing the book, the play or the song. No-one would dream of making every team in a soccer or baseball league deal direct with every viewer, in order to ensure that the user only paid once, regardless of the number of channels showing the game.

3) Limits on market data services income as percentage of total

This approach offers another big payday for the management accountants and lawyers - or a job for life if it's adopted. ESMA can expect any number of examples to show why market data services income can't be measured on a good enough basis for comparison or for practical limits, why limits of overall market data services income would provide no effective restraint on fees for the data and data usage rights covered by MiFID, and why a firm that has spent millions acquiring or building up, say, a global index or data vending business should not have its market data fees more tightly restricted as a result.

Again a fundamental problem with this approach is the underlying assumption that market data fees and services relate to the supply and consumption of a raw material commodity, rather than to the licensing of valuable intellectual property for a range of commercial uses that is rapidly expanding as the result of technological change. So, even if enough accountants, lawyers and chargeable hours are employed to establish a standard basis for comparison, there is no logical reason why the resulting limits would provide a reasonable measure of the economic and commercial value of any specific market data usage rights.

4) Fees per user

One of the consequences of the sheer lack of transparency of market data fees structures is that the vast weight of "expert" economic analysis, argument and lobbying of regulators has fallen on the amount of the headline monthly display fee for professional users or devices. The ESMA CP makes a rare foray into underlying fee policies with its suggestion that these fees should apply once per user, regardless of the number of services via which the user accesses the data. Unfortunately, the CP fails to identify or address the reasons why most fees are not already paid on this basis.

Let's leave aside for now the fact that fees per user don't usually apply to the "non-display" automated trading and execution support activities which count for most use of most market data by market participants. What needs to happen, if it's mandated that all "display" fees must be paid on the basis of one fee per user, regardless of the number of sources or services through which that user accesses the market data?

First, there needs to be a single contract covering each user's use of data from any source or supplier. This ought to be possible in theory, but in practice most European exchanges and venues have contracts with their data vendors to report and pay market data fees for the use of market data by the vendor's customer firms. Each vendor can only pay fees relating to the service it provides the customer firm. No vendor can be expected to know about or control the use of data

supplied to its customers by its competitors. Only a tiny minority of exchanges have direct market data agreements with every customer firm.

So if per-user billing is mandated each customer firm needs to have a new contract for nearly every venue. In addition, the data vendors need to be released from their obligations to bill market data fees to each customer from the time it is covered by a new direct agreement.

If ESMA mandated per–user fees under today's business model there could be over 70 sources trying to introduce new direct market data agreements and policies, each requiring its own monthly reports, each with its own audit rights, each having to square the new agreements with its existing contracts and side-letters with data vendors. How many market participants would have the time, resources and desire to pay for their market data on this basis? How many venues and data vendors could cope?

The per-user fees issue provides a useful reality check on the other options in ESMA's paper for controlling market data costs. Price list publication would have no effect whatsoever. Cost-based controls on fees or limits on market data services income would not prevent venues from simply putting up other data fees to make good any shortfall in their income from the mandated use of fees per user. None of these approaches would identify, let alone restrict, the extra administration cost and burden for data recipients of direct agreements with each venue. And cost-based limits would enable venues to incur unlimited additional market data administration and regulatory compliance costs and pass them on direct to the customer.

It's all too easy for the medicine to do more damage than the disease, although it would be more accurate to describe the fees per user issue as a symptom, not a disease.

The chronic disease responsible for this and many other distressing symptoms is a market data licensing structure that still tries to follow the 1970s business model of data distribution and consumption, decades after trading technology has transformed the operation of financial markets.

B) The Road Forward

ESMA's CP highlights the difficulty of superimposing any cost-effective, fair and enforceable approach to the regulation of consolidated market data onto an outdated and fragmented contract structure. Once we realise we need to build a sustainable 21st century data licensing structure fit for a global trading environment, the problems highlighted by ESMA's CP and the European consolidated tape begin to look like an opportunity and a good starting point.

We suggest 5 steps to help implement the European consolidated tape, reduce cost and complexity and provide a fair, reasonable and sustainable model for market data licensing and regulation in today's interconnected markets.

1) Define Regulated Access Rights

Recognise that not all market data fees are relevant to the aims and scope of the regulation. Define the contractual data usage rights that need to be covered by regulation. Focus transparency requirements on the publication of fees for these "Regulated Access Rights"[2].

The extent of "Regulated Access Rights" will no doubt be subject to debate in each regulatory jurisdiction, but should be determined by reference to underlying legal requirements. Our analysis

[2] See our 2012 white paper Market Data Licensing and Regulation in a Global Trading Environment for further discussion of the concept of "core data usage rights" as an extension of the "core data" concept used in SEC equities regulation.

of the text of MiFID II/MiFIR indicates that three particular Regulated Access Rights are strongly implied, as follows:

- The right of private investors to receive and view market data for the purpose of managing the private investor's own investments.
- The right of market participants to access market data (via data display terminals and/or non-display trading applications) for the purpose of trading the instruments to which the market data relates.
- The right of any recipient of the market data to use the data for the purpose of meeting regulatory requirements.

2) For "reasonable", read "non-discriminatory"

The text of MiFID II/.MIFIR contains several references to requirements for market data terms to be non-discriminatory, but none of the approaches to reasonable commercial terms suggested by the CP pursues a requirement for non-discriminatory pricing.

In practice individual side-letters and agreements between data recipients and data sources often use so-called "most-favoured nations" clauses to ensure that - whatever happens to price levels and structures - the recipient can use the data on no less favourable terms than any other person making similar use of the same data.

We therefore recommend that the MiFID II/MiFIR regulatory regime focus on "non-discriminatory" as the aspect of "reasonable commercial terms" which can be most easily be translated into regulatory rules, without the need for complex calculations and contentious limits.

ESMA and other regulators would not then need to be involved in the minutiae of contracts. Cost control can be established for the European consolidated tape simply by specifying a high-level anti-discrimination rule for fees applicable to Regulated Access Rights. For example:

> "Fees specified by any venue for any Regulated Access Right to its market data as made available via the Consolidated Tape shall not exceed the lowest fee charged to any person for the same or similar right to the same market data, as made available via any other means."

3) Leave outdated limits behind

Leave the trench warfare behind. Forget about any cost-based or income limits derived from management accounting allocations and ratios. Even in a single regulatory jurisdiction it's hard to see how these could work. Across 28 European states, each with its own national securities regulators and competition authorities, either approach is far more likely to exacerbate the costly and ineffective bureaucratic nightmare we already have.

An anti-discrimination principle as described above could be far more targeted, cost-effective, adaptable and sustainable in the long-term, much easier to apply across national borders, harder to challenge and harder to avoid

4) Use a licensing agency to administer Regulated Access Rights

Set up a data licensing agency under ESMA supervision to work alongside the CTP(s) and deal with European venues and market participants for Regulated Access Rights to Consolidated Tape data. Allow individual venues, market participants, data vendors and CTPs to own stakes in the agency but not to control it. Keep the licensing agency separate from any CTP or data distribution activity.

5) Let the agency provide an industry solution to other market data problems

Allow the agency to act commercially as a one-stop shop for other data usage rights as between market participants and trading venues inside and outside Europe, with a brief to promote per-

user billing, enterprise licences and other simplified fee structures tailored to the needs of market participants.

A central licensing agency to administer Regulated Access Rights would be the simplest, least burdensome and most cost-effective way of facilitating the European consolidated tape and meeting MiFID II/MiFIR requirements for market data regulation. It could be established either by regulators or by the industry as part of the "industry solution" envisaged by the EU authorities.

In its regulatory implementation role, the licensing agency would be well-placed to meet transparency requirements, publish and collect fees for Regulated Access Rights and administer any anti-discrimination rule. CTPs and data vendors would still bill their clients their own charges for the aggregation and the delivery of data. They would refer clients to the agency as a single point of contact for all Regulated Access Rights and either to the agency (if possible) or to direct agreements with venues (if necessary) for other data usage rights to market data.

Fees for Regulated Access Rights to consolidated tape data would be based on input fees specified by the venues in accordance with any specific anti-discrimination rules. The aggregated fee for each applicable Regulated Access Right would be billed by the agency to each recipient and the component fees would be remitted to venues by the agency, in the same way as data vendors bill subscribers and remit market data fees to exchanges. There would be no need to allocate consolidated tape income on the basis of any arbitrary formula and therefore no threat of distortion to trading patterns by venues seeking to maximise their share of fees income from the consolidated tape.

Recipients of consolidated tape data would report their use and pay fees on an aggregated basis to the agency rather than having to report and pay component fees to each venue.

A licensing agency could function regardless of whether Europe adopted a single or multiple CTP industry solution or was forced to move to a mandated central CTP. It would greatly simplify the business model for prospective CTPs. With all regulated market data fees administered by the agency, CTP aggregation and delivery charges could be controlled either via competition between CTPs or by regulation as for a public utility.

All these measures could be set up within the time-frame envisaged for the establishment of a consolidate tape in Europe. The costs of an agency to administer Regulated Access Rights and associated fees would be relatively low and predictable. Over time these could be funded by the agency's commercial operations.

In its wider commercial role the agency could radically reduce the cost and complexity of market data licensing, administration and compliance for venues, data vendors and their customers. It would offer an alternative to bilateral agreements between end users and each venue for rights to both pre-trade and post-trade data. It could have a single customer contract and standardised fee structure. It could use a single audit for compliance purposes, saving its customers the burden of separate audits from each venue. It would be well - placed to implement per–user, enterprise and community licence fees and to develop and promote new standard fee structures tailored to the evolving needs of its customers.

This wouldn't be a solution to all our market data problems, but at least the data licensing arrangements for the European consolidated tape would be showing a practical way forward from the old trench warfare, towards a sustainable and cost-effective model for the 21st century.

C) Taking the first steps

We understand ESMA and national securities regulators do not wish to become directly involved in the minutiae of data licensing contracts or business models. This implies that any cost control regime will effectively have to be implemented by some form of "industry solution". Yet the

experience of prospective CTPs over the last three years has shown that industry solutions are unlikely to take shape unless a commercially viable framework can be specified by regulators.

We therefore suggest that the following steps be taken by the regulators responsible for implementation of MiFID II/MiFIR:

- Specify the Regulated Access Rights arising from MiFID II/MiFIR
- Specify the transparency and anti-discrimination rules deemed necessary to ensure that Regulated Access Rights to consolidated tape data are available on fair, reasonable and non-discriminatory terms.
- Require venues and prospective CTPs to ensure that fees for Regulated Access Rights are available in accordance with transparency and anti-discrimination rules.
- Invite prospective CTPs, venues, data vendors and market participants to consider and propose the establishment of a data licensing agency as part of the "industry solution" for the consolidated tape anticipated by MiFID II/MiFIR, before any mandatory solution is imposed.

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