OPINION

Blunting the rapid escalation in market data fees to improve investment returns

IAN RUSSELL
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Increased operating costs are affecting investors and dealers in capital markets across all major securities jurisdictions, and these rising costs are not just from new technology and compliance costs from regulatory reform. These costs are from the inexorable rise in fees charged by trading and clearing infrastructure in the marketplace, most particularly the rising cost of market data.

Market data costs are included in the cost of investing and typically passed through to the investor, and the rise in data fees has now reached the point of having a significant bearing on the costs of investing and on net investment returns. These large and rising data fees paid by asset managers will have a disproportionate impact on small specialized funds investing in speculative, small cap publicly listed and private equity shares, interfering with the capital formation process in the small business sector.

The traded prices of equity shares and exchange-traded funds on individual stock exchanges and trading platforms, and related array of stock market indices, are required by investors and dealers to ensure best trade execution, and to measure trading performance against defined index benchmarks for passively managed funds. This near-inelastic demand for transaction prices has given stock exchanges and other trading platforms the latitude to raise fees for their market data.

The Investment Industry Association of Canada estimates that fees for market data have increased on average about 11 per cent a year during the past 13 years. (While it is difficult to obtain precise figures on historic trends in fees charged for equity transactional data because of frequent bundling and re-bundling of data packages, this estimate is based on stock-exchange revenue earned from data fees, compared with revenues from listing and execution.) This increase in data fees is astounding by any measure, especially in view of the modest underlying annual inflation of less than 2 per cent and technology applications that should lower the cost of data packaging and distribution. The reality is that higher revenue from market data has compensated for weaker trade execution revenue at stock exchanges, contributing to continued earnings gains and share price increases.

The phenomenon of relentlessly rising market data charges is similar in European capital markets and the United States. Copenhagen Economics, an independent consulting firm in Europe, has produced recent analysis indicating that fees for stock and ETF-transaction prices have been on a similar upward trajectory as Canada. The Securities Industry and Financial Markets Association has undertaken recent independent analysis of market data fees and concluded that data fees paid to stock exchanges in 2018 were at least 10 times higher than the same fees charged in 2010.

Through all this, the regulators have been strangely benign, seemingly reluctant to disapprove continued requests for data fee increases. Some regulators, such as our Canadian Securities Administrators (CSA), have defined methodologies to assess proposed fees based on market share of the marketplaces, the rationale for the fee increases, the underlying costs to produce the data and resulting widening in margins and the fairness of charges to investors, particularly small investors.

In May of this year, the U.S. Securities and Exchange Commission (SEC) stepped up to the plate and announced a set of rigorous guidelines, SEC Staff Guidance on SRO Rule Filings Relating to Fees, that stock exchanges and marketplaces must follow when submitting requests for proposed market data charges. These guidelines are in response to recent renewed regulatory focus on market data fee increases, especially by the European Securities and Markets Authority (ESMA) in connection with new Markets in Financial Instruments Directive II requirements for transparent and reasonable data fees and, in the U.S., recent litigation between the stock exchanges and securities industry over data charges.

Canadian and foreign regulators may, based on the general wording of the regulation, ask marketplaces similar questions to justify their fee increases. However, in the U.S., stock exchanges must now explain and justify in detail, against a set of specific public interest guidelines and directions, why fee increases are reasonable and fair and what their impact is on competition and investors in the marketplace. Further, in June, the Nasdaq exchange initiated consultations on different data fee-setting arrangements among investors, reflecting concerns that data fees discourage Main Street investor participation in equity markets.

No longer will it be simply left to the discretion of the stock exchanges to give an open-ended explanation or rationale for fee increases. We know that foreign regulators, the CSA in Canada and ESMA in Europe, are watching developments in the U.S. closely, particularly to see if the new guidelines will break the steady upward trend in data fees charged to investors and intermediaries. We are hopeful the SEC action will spur a new approach to the scrutiny of market data fees in Canada.

Ian Russell is President and CEO of the Investment Industry of Canada and Past Chair of the International Council of Securities Associations