

CSA Staff Notice 21-312

Update on Consultation Paper 21-401 Real Time Market Data Fees

November 7, 2013

A. Introduction and Background

On November 8, 2012 the Canadian Securities Administrators (the CSA or we) published for comment Consultation Paper 21- 401 *Real Time Market Data Fees* (Consultation Paper)¹.

The Consultation Paper discussed issues associated with real-time market data fees and potential regulatory options to address them. The issues described in the Consultation Paper fall into three themes:

- The level of data fees charged by marketplaces;
- The view of the dealer community that they need to have access to data from all transparent marketplaces to comply with regulation, which makes them a “captive market” for real-time market data; and
- Transparency is needed in the regulatory review of fees.

The analysis in the Consultation Paper focused on the fees charged for consolidated data, identified a number of possible options that could be used to address the issues² and requested feedback.

The purpose of this CSA Staff Notice is to summarize the comments received from industry on the potential options set out in the Consultation Paper and to discuss the CSA’s next steps for addressing industry’s concerns with real-time market data fees.

B. Comments Received

Sixteen comment letters³ were received, with the majority of comments submitted by marketplaces and market participants⁴. A description of the options and a detailed summary of comments is attached as Appendix A.

¹ Bulletin of the Autorité des marchés financiers , November 8, 2012, vol. 9, no. 45, p. 276.

² The issues associated with the captive audience will be addressed in the ongoing review with respect to the Order Protection Rule (OPR). For more information see Part D Next Steps.

³ The marketplaces that made a submission were: Chi-X Canada, TMX Group, Omega ATS and CNSX. Dealers that submitted comments were: RBC Dominion Securities, TD Securities, BMO Capital Markets, and ITG Canada. Advisory firms submitting comments were RBC Global Asset Management and State Street Global Advisors. Industry Associations submitting comments were Securities Industry and Financial Markets Association (SIFMA), Investment Industry Association of Canada (IIROC), Association for Financial Markets in Europe (AFME). Other commenters were Bloomberg, Cossiom (a data user group) and a retail investor.

⁴ Market participants include commenters from both dealers (sell side) and advisory firms (buy side).

Marketplaces

Smaller marketplaces were not supportive of the two options linking data fees to the level of activity on a marketplace. They expressed concerns that these two options would be detrimental to the Canadian market; specifically, that such an approach would create greater barriers to entry for new marketplaces and may lead to reduced services and choice for market participants.

Smaller marketplaces favoured a regulatory response that would see the creation of a utility that would collect and distribute data at a “fair and equitable” price. However, they had differing views on how the utility should be overseen including how its fees should be regulated.

Larger marketplaces partially supported the introduction of fee caps that would prevent significant future fee increases attributable to marketplaces with minimal market share (of trading activity) and possibly impact an increase in the number of new marketplaces. Larger marketplaces were supportive of a regulatory approach that would assess the value of a marketplace’s data, which would take into consideration a variety of factors beyond market share, such as changing market conditions.

Some marketplaces suggested additional regulatory approaches for real-time market data fees. These regulatory approaches are described in Part C of this Notice.

Market Participants

Market participants were in agreement that real-time market data fees should be regulated; however, they disagreed on the appropriate approach for the Canadian market. Most commenters observed that a sound regulatory approach should ensure the fees charged for real-time market data reflect the “value” of a marketplace’s data.

Generally, market participants did not support the three options where real-time market data fees are regulated through the information processor (IP). They thought these options were either too complex to administer or would disadvantage a large proportion of real-time market data users.

There was also limited support for a regulatory approach that would limit real-time market data fees charged by new marketplaces whereby the fees levied would vary according to a marketplace’s level of trading activity. Market participants were concerned with the complexity of this option and its potential abuse by marketplaces.

The option that received the most support from market participants was the proposal to cap real-time market data fees until a marketplace’s trading activity reaches a *de minimis* threshold established by regulators. It was acknowledged that this option would not address concerns about existing fees currently charged by marketplaces.

One marketplace participant did not support any of the options presented in the Consultation Paper and instead proposed a different approach for regulating real-time market data fees. This approach is presented in Part C of this Notice.

Industry Associations

Three industry associations submitted comment letters. They were the IIAC, the SIFMA in the U.S. and the AFME. These industry associations agreed that regulation of real-time market data fees is necessary; however, their views differed on the best approach.

IIAC advocated an approach where fees for core data are based on the cost to produce real-time market data. The fees for core data would be used to establish the value of market data sold by the IP, directly by the marketplaces or service providers. SIFMA favoured the establishment of a mandated data utility to operate on a cost recovery basis in association with the publication of fees for comment. It cautioned against narrowly defining core data, as this may lead to major tranches of significant data being excluded from the core data feed. The AFME favoured the regulation of consolidated data fees charged by the IP either in conjunction with the publication of marketplace fee amendments and fee models for comment or by establishing a fee cap on core data.

C. Additional Options Proposed by Commenters

A few commenters suggested additional options on a regulatory model that would benefit the Canadian market.

Two commenters suggested the creation of a designated industry vendor as the sole provider of Canadian market data. The designated vendor would have responsibility for data distribution and revenue distribution amongst marketplaces. Unlike a pure utility model, the designated data vendor would be permitted to earn a profit. Marketplaces would share revenues based on their contribution to price discovery. No revenue would be distributed to marketplaces that fail to reach a minimum level of market activity. Governance of the designated vendor and the revenue sharing formula would be overseen by an oversight committee or a board. The option would help control real-time market data fee costs by preventing marketplaces from charging for market data until certain market quality conditions are met.

Another commenter suggested that regulators facilitate the creation of an industry body that would enter into agreements with each marketplace to allow the administrator to license a consolidated data feed and other data products to vendors. The contractual terms and conditions of the administrator's vendor license would be regulated by the CSA. The commenter suggested using the "indirect billing" model where vendors would collect a fee per end user for the administrator. The administrator would apportion the proceeds, less operating costs to the marketplaces in accordance with a formula to be agreed upon. End users would not have to contract with the administrator since the terms and conditions of the consolidated data license would be covered by existing agreements between the end users and vendors. In this commenter's view, this approach would evenly distribute trade and quote information from all visible marketplaces and provide users with market data services at a reasonable price that would reflect a marketplace's contribution to price discovery.

One other commenter suggested that what should change is the mandatory requirement to buy or display all marketplaces' data on every professional terminal. This commenter is of the view that the CSA should help articulate the guiding principles in this regard. In this context, a marketplace's trading activity should reach a *de minimis* threshold before that marketplace can start charging for data. The *de minimis* test should include a wide range of criteria to evaluate the value of a marketplace's data. The value of data would take into consideration each marketplace's contribution to market quality, for example, to price discovery. These criteria would form the basis of a Fair Value Fee Model that would be used to establish the fee that a marketplace could charge.

D. Next Steps

The comments received from the Consultation Paper are varied with respect to the approach to regulating real-time market data fees. Of the eight options proposed in it, only the following two garnered some level of support from some of the stakeholders who commented on them

1. Limiting real-time market data fees charged by existing or new marketplaces until they reach an established activity level – this option was supported by marketplaces and market participants, although some of the smaller marketplaces were opposed to this approach.
2. Publishing data fee proposals and changes to fee models for comment – this option was supported by all industry associations and one market participant.

As noted by commenters, these options do not address concerns about the level of fees currently charged by marketplaces that are above the threshold. CSA staff are of the view that these two options, along with possibly defining core data or the core data products that are needed to comply with regulatory requirements, although considered partial solutions, should be explored further to assess whether they could be part of a regulatory framework for real-time market data fees in Canada.

The Consultation Paper does not ask any particular questions about the role of the existing IP, however any steps taken to regulate data fees would impact the IP and its model for data distribution.

The creation of a data utility or a similar entity is a complex solution for a small market. It would be costly and take a significant amount of time and resources from the CSA and industry to develop due to the many issues that it would have to address. It would also require legislative changes and new regulations in many CSA jurisdictions. CSA staff are of the view that this option may be considered in the long-term.

Currently, CSA staff are reviewing the Order Protection Rule (OPR) that generally requires that all better-priced limit orders are executed before inferior-priced limit orders and are not traded through. As noted in Part A of this Notice, the view of the dealer community is that in order to comply with the OPR requirements they have to access trading and real-time market data from all transparent marketplaces, which makes them a "captive audience". This "captive audience" issue is a key factor with respect to the review of market data and OPR and therefore, we will be continuing the examination of data fees in the OPR review. In particular, as part of the OPR review, CSA staff will be considering the impact of OPR on fees, including market data fees. In

addition, staff will be working toward the creation of a methodology for the evaluation of all such fees proposed to be charged by marketplaces. The OPR review process is ongoing and feedback from stakeholders will be requested at a later date.

E. Questions

Please refer your questions to any of the following:

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APPENDIX A

SUMMARY OF COMMENTS RECEIVED FOR EACH OPTION PROPOSED IN THE CONSULTATION PAPER 21-401

Option 1 - Cap Fees for Core Data

The first option discussed in the paper proposed to cap fees for core data. This option would define a set of data as “core data” that would include only that data that would be necessary to comply with regulatory requirements. The regulatory authority would then regulate the fees applicable to this core data, whether distributed through the IP or through the marketplaces. Since core data would not necessarily need to include all data elements that are currently in market data feeds, this data could be available at a lower price.

Marketplaces would be free to set fees for non-core real-time data products, subject to the normal fee review and approval process. To prevent marketplaces from bundling core data with other data as a way to circumvent the pricing restrictions, marketplaces would be required to offer core data as a stand-alone product.

Comments Received

Support for this option was mixed. Some commenters thought this option, in combination with other levers could be a partial solution to addressing cost concerns. Other commenters fully rejected this option because they were concerned that this option could create more problems than it solved. Overall most commenters did not view this option as a viable solution.

Concerns were expressed about the definition of core data. A definition that is too narrow could unintentionally lead to necessary data falling outside the scope of protection. One commenter believed that the definition of core data could not be static; therefore, creating and maintaining this product may be costly and defeat the objective of making it available at a lower price.

Another contentious issue was how the caps for core data should be set or whether there should be any caps at all. Three commenters supported basing the caps on the cost of data production while others viewed the fair value of data as the starting point in setting the caps. One commenter expressed concerns that any referencing to the cost of production, market share, rates of return or any other benchmarks may generate unintended distortions in the market with respect to costs.

A few commenters discussed the competitive and business impacts of implementing such an option. One commenter stated that this option does little to address the competitive imbalances that are present in the current model for market data distribution. Furthermore, this commenter believes that adopting this option will lead to further increases in costs for certain marketplace subscribers and incent marketplaces to develop other types of data products to further capitalize on the revenue generating potential of their market data function.

Option 2 – Cap Data Fees Charged by a Marketplace until it Meets a *De Minimis* Threshold

The second option proposed to impose a cap on the fees that a marketplace could charge for its market data until it reaches a *de minimis* threshold for a period of time. This threshold could be based on market share or market share combined with some other metric. The cap could be set at zero or at a nominal amount until the threshold is met. If a marketplace falls below the *de minimis* threshold for a certain period of time, its market data fees would be subject to the cap until the marketplace moves above the *de minimis* threshold again.

The cap would not apply to marketplaces that are above the *de minimis* threshold. Marketplaces in this situation would be able to set fees, subject to the approval process in place.

Comments Received

We note that six commenters⁵ agreed that the option, as presented, would not address the fees currently charged by some of the existing marketplaces.

Five of these six commenters view this option as a potential partial solution. One of these commenters suggested that we should eliminate data fees for marketplaces that are not “materially contributing” to price discovery while two other suggested that establishing a threshold for charging data fees would be a viable option to lower the overall cost of market data incurred by marketplace participants. There was no agreement on the level of this threshold, as one commenter suggested a one per cent market share, whereas the other thought a five per cent market share would be appropriate.

Two other commenters⁶ agreed that capping fees would be preferable to the existing situation.

Marketplaces also had differing views on this option. Smaller marketplaces did not support the adoption of a *de minimis* threshold, with one generally opposed to caps being set on individual marketplace services. Smaller marketplaces were concerned that this option could create significant barriers to entry for new marketplaces and result in unintended consequences. Additional consequences cited included: a reduction in the quality of real-time data and data processing and distribution, incentives for marketplaces to promote practices that would artificially increase their market share or, in the case of dominant marketplaces, to self-fragment to charge multiple times for their market data.

The two larger marketplaces supported the adoption of a *de minimis* threshold before fees could be charged by a marketplace, but their views differed on the application of the fee. One marketplace suggested the *de minimis* threshold should be met before any fees could be charged, whereas the other limited the application of the *de minimis* threshold to only data fees. These two marketplaces mentioned that this approach may reduce the proliferation of new marketplaces with minimal activity and value. It would also prevent marketplaces from solely surviving on their market data revenue.

⁵ Three investment dealers, one adviser and two industry associations.

⁶ One industry association and a data provider.

In terms of the factors that should be considered and the measurements that should be used in establishing the *de minimis* threshold, commenters suggested considering a broader range of quantitative criteria, beyond market share, and that the threshold should be dynamic to reflect changing market conditions.

Option 3 – Cap all Data Fees for All Marketplaces Starting at a *De Minimis* Threshold and Gradually Increasing the Threshold and the Applicable Caps

This option would limit the level of market data fees individually charged by all marketplaces, on an individual basis. It would prevent any marketplace from charging fees that are not reflective of its market share.⁷ Additionally, the tier fee caps and *de minimis* thresholds structure would keep fee increases in check by tying them to a marketplace’s market share.

We explained in the Consultation Paper that we have not decided what the *de minimis* threshold metric could be; however, to facilitate an understanding of the option we used market share as the *de minimis* metric. We also explained that the cap for the *de minimis* threshold could be set at zero or at a nominal amount until the *de minimis* threshold is met. The cap would increase when a marketplace moves beyond the *de minimis* market share threshold and, conversely, the cap would decrease to a lower level if a marketplace regresses back to a lower market share threshold. Similar to option 2, a marketplace must remain above a set threshold for a certain period of time before it can increase its fee up to a level that corresponds to the threshold tier it is in.

Comments Received

This option did not gather much support from commenters. All marketplaces, regardless of their size, regarded this option as having many unintended consequences, such as:

- Creating greater barriers to entry for new marketplaces;
- Limiting the number and range of new services that a new marketplace may offer;
- Creating an overtly utilitarian model that is burdensome, costly and subject to abuse.

Only two market participants felt that this option would be effective in more closely linking a marketplace’s fees to its market share. Another market participant stated that this option is complicated and subject to abuse by marketplaces, in that a marketplace may reach the minimum threshold for charging data fees by printing block crosses instead of actual trading activity. This view was also shared by two industry associations that agree this option would add an element of complexity to fee regulation and necessitates constant monitoring of the chosen threshold.

Option 4 – Cap Fees for Data Sold Through the IP

This option would cap the fees that marketplaces charge buyers who purchase their data from the IP. All marketplaces would be subject to a cap, although not necessarily the same one (as in option 3). This model preserves the pass-through fee model but caps the costs that could be passed through. The cap could be set by the regulators and implemented through a rule.

⁷ Similar to the previous option, the *de minimis* threshold could be based on market share or market share combined with some other metric.

Marketplaces would still be free to set fees for direct subscribers and vendors, subject to the normal fee review and approval process. This option would create a lower-cost consolidated data feed from the IP. As many users do not need to purchase data directly from marketplaces (e.g., users that are not latency sensitive) this option could address their concerns. Users whose business models require them to purchase data directly from the marketplace or from third party vendors would not necessarily see a direct benefit in terms of lower costs, but the existence of a lower-cost alternative may impose some market discipline on data prices generally.

Comments Received

Many commenters had concerns about this option. Two marketplaces thought this option would create two classes of marketplace participants: those with all the data and those without. Another marketplace thought this option implies that the manner of data delivery and not the content would dictate the fees charged by marketplaces. In addition, a number of commenters expressed a concern that this option would penalize market data vendors who obtain data directly from the marketplaces and consolidate data using proprietary means. To be beneficial to all market participants, the fee cap must apply to data delivered by the IP, by marketplaces and by other data vendors.

Generally, marketplace participants also had concerns about this option. While one participant supported the notion of an affordable consolidated feed of all Canadian marketplaces, others believe fee caps should apply consistently regardless of whom the data was purchased from.

In addition, two commenters noted that this option retains the problematic pass-through model which does not provide an effective cap on market data fees, as the data fees charged by new marketplaces would still drive up the total cost of market data.

Option 5 – Regulate Consolidated Market Data Fees Charged by the IP

This option would directly regulate the fees charged by the IP for consolidated data rather than the fees charged by marketplaces. This model would eliminate the pass-through model but would necessitate creating a different fee and compensation model for the data fees. This option would not regulate fees for data sold directly by marketplaces.

In this option, the IP and not the marketplaces would set the fee for its consolidated data, subject to approval by the regulatory authority. The fee could be determined by a rule of the regulatory authority, the IP independently or co-operatively by the marketplaces, as is done with consolidated data in the U.S. Marketplaces would share in the IP's revenue on a pre-determined basis, either by agreement or rule or as approved by the regulatory authority. Under this option, marketplaces would be free to set fees for direct subscribers and vendors, subject to the fee review and approval process.

This approach is similar to the approach taken in the U.S., where the revenue from the consolidated data distributed by the securities information processors is allocated by a set formula (approved by the Securities and Exchange Commission).

This option requires legislative amendments to the securities regulatory authorities' jurisdiction to specifically regulate the operations of the IP and the fees charged for its products.

Comments Received

Two marketplaces partially supported this model because they believe this option is a step in the right direction in addressing data costs. Nonetheless, they raised questions about the appetite of both industry and regulators for such a direct interventionist approach and questioned why the fees would only be regulated for the IP. Additionally, only regulating the IP would lead to significant administrative and compliance risks and costs for marketplace participants.

One marketplace did not support this option, as it believed the Canadian market cannot afford the cost and resource expenditure of imposing a centralized consolidated tape sharing regime.

Marketplace participants were divided in their support for this model. Two commenters considered this model to have some merit, particularly in the area of revenue distribution. Two other marketplace participants believe this model is deeply flawed because it only regulates the slowest data feeds available therefore subscribers seeking price protection on data will be disadvantaged. This option also introduces an element of complexity through the revenue distribution formula.

One industry association did not support the option as presented. It, however, believes that consolidated market data sold through the IP should be regulated by regulating the price of core data and establishing a formula to allocate it to the marketplaces when it is purchased through the IP.

Option 6 – Cap Consolidated Data Fees Sold by Marketplaces to all Data Vendors, Not Just to the IP

This option is also similar to option 4, however, instead of capping the fees that marketplaces charge buyers who purchase data directly from the IP, the fees that marketplaces charge buyers of consolidated data from all data vendors would be capped. Marketplaces would be free to charge whatever fees they determine appropriate for non-consolidated data whether distributed by vendors or by the marketplaces directly. This will allow all data vendors to distribute the consolidated data at the same lower, capped rate as the IP to marketplace participants.

Comments Received

Only one commenter believed that this approach has merit; however, the commenter suggested the scope of this option should be expanded to include all data providers.

Other commenters were of the view that this model would:

- Perpetuate all of the unintended consequences of the pass-through model;
- Not necessarily lead to the best end result for users as the cap only affects the cost of receiving the consolidated data, and does not consider the cost of producing this data;
- Create perverse incentives for trading venues to design faster direct feeds while not spending similar resources to improve price-capped feeds; and,

- Potentially limit new consolidated market data entrants.

Option 7 – Mandate a Data Utility to Operate on a Cost-Recovery Basis

This option suggested the creation of a “public utility” source of consolidated market data in Canada.

A mandated data utility could be funded by marketplaces and/or data customers and would operate on a cost-recovery basis. Any revenue generated from the selling of the consolidated data would be divided amongst the utility participants based on a revenue sharing model agreed upon by all parties involved. The amount of revenue that each participant receives would be proportionate to their contribution to price discovery and liquidity. This utility would have to be overseen by the regulatory authority as it would be providing a service critically important to the capital markets.

This option is similar to Option 5, except that it would be developed by the industry rather than imposed by the regulatory authority. Legislative amendments and an overhaul of the transparency requirements would be needed if a public data utility was created.

Comments Received

Many commenters agreed that, in theory, this option is the best of all eight presented in the Consultation Paper; however, most had significant concerns with respect to the time and effort needed to create, implement and govern this utility. For instance, five commenters (four investment dealers and the domestic industry association) agreed that the creation of such utility would be quite costly and present certain challenges, such as:

- Ensuring there is a process in place to allocate resources to the development and management of this utility;
- Establishing a governance framework agreeable to all stakeholders;
- Implementing a transparency regime around the cost of producing the data and the revenue sharing model;
- Ensuring there is proper technology in place for data distribution.

Although they agreed that this option best addresses the issues raised by stakeholders, two marketplaces expressed different views on how this utility should function. One believes that this utility should be overseen by regulators and it should only distribute core data. The other is of the view that marketplaces should be given the opportunity to establish the pricing and revenue allocation before intervention from regulators. Pricing and terms and conditions should be subject to initial approval by regulators.

A single marketplace felt this option was not viable because the Canadian market cannot absorb the cost and expand the resources to impose a centralized consolidated tape sharing regime.

Finally, one other commenter observed that a utility would reduce costs in the short term but would not promote competition for data services in the long term.

Option 8 – Publish Amendments to Market Data Fees and Fee Models for Comments

This option would require a marketplace to publish for comment any amendments to its market data fee schedule. We could require marketplaces to also publish the rationale for amending the fees and a pre-implementation impact analysis at the time their proposed fee changes are filed with the regulatory authority for approval. This would impose some discipline as marketplaces would have to publicly justify any changes to fees and/or fee models.

Comments Received

Most market participants indicated that while greater transparency around fee changes would be beneficial, the publication of amendments to market data fees will not address the existing high fees, nor restrain marketplaces from introducing new fees or increase their fees in the future. Only one market participant supported this option, suggesting that, in addition to the publication of data fees, CSA staff should consider the publication of proposed changes to trading fees as well.

Marketplaces thought increased transparency would have a detrimental impact because it would not lead to productive results and it would unfairly penalize first mover advantage while rewarding a competitor that follows.

All three industry associations agreed that the publication of market data fees changes and fee models for comment would be a valuable addition to any of the options proposed in the Consultation Paper. It, however, would not be effective as a stand-alone solution as it does not address the issues related to high real-time market data fees.