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## **COST-BASED PRICING: A SOLUTION TO EXCESSIVE MARKUPS FOR MARKET DATA**

## Cost-Based Pricing: A Solution to Excessive Markups for Market Data

Broadly speaking, monopolies are inefficient. They can set prices to maximize profits and extract a significant producer surplus, as they are not constrained by competitive market pressures. The absence of market forces that typically drive innovation and efficiency allow monopolies to charge higher prices simply because they are the sole providers in their market. The existence of monopolies is often due to the high costs associated with entering the industry, such as significant investment in infrastructure, or when regulation acts to extend privileges to firms, such as patents or other mechanisms.

### Market Data Providers – Quasi Monopolies

In the securities market, there is considerable competition in the trading, limited competition in the listing, and virtually no competition in market data. Stock exchanges, when functioning as market data providers, operate in a niche segment, demonstrating many of the hallmarks of a monopoly. The securities exchanges have successfully demanded unearned intellectual property rights from the issuers and investors' agents for their products. And since they operate in a highly regulated environment, this should only be available to them if it is in the best interest of the issuers and investors.

Currently, this is not the case as monopolistic price setting is not based on a competitive demand and supply mechanism. Consumers of market data pay the price because the product is critical to their business – in fact, it is a requirement for many firms that they must subscribe to high quality market data to meet their regulatory obligations. In a previous report, we highlighted Canadian concerns about the significant weaknesses in the commercial market data process. These weaknesses are not just about the pricing models but also extend to the type of product being offered. As a reminder, these weaknesses are:<sup>1</sup>

- No complete, regulated, consolidated feed
- No standardized format for market data among providers, leading to fragmentation
- An antiquated 15-minute standard for delayed data
- Complex market data policies and auditing practices
- No material public oversight of market data fee levels and increases; and
- No standard-setting body to reduce operational and data management complexity.

Further, our exchanges, as highlighted in the August 2023 IIAC commentary, originally had simple goals, which were to “provide a low-cost trading facility, to invest enough in technology to ensure

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<sup>1</sup> IIAC Response to CSA Consultation Paper 21-403 Access to Real-Time Market Data, February 10, 2023, available at: <https://iiac-accvm.ca/wp-content/uploads/2023/02/IIAC-Response-to-CSA-Consultation-Paper-21-403-Access-to-Real-Time-Market-Data.pdf>

continued operation in the most stressful conditions, and to ensure that quality information was available to members and their customers.”<sup>2</sup> With data sales now becoming a large component of revenues for the exchanges, the prices being charged have exceeded the ‘reasonable margin’ levels expected from the data producers.<sup>3</sup> This leads to inefficiencies in the marketplace and deteriorating market quality, a characteristic of an environment dominated by monopolies.

### IIAC advocates for cost-based pricing models

We are fully aware of the ongoing debate and the arguments assessing the benefits of *value-based* vs. *cost-based* pricing. Value-based pricing is the fundamental cornerstone of a free market economic system. Anytime a product or a service of value is being delivered, the owner deserves to be paid the fair market value for that product or service as determined by the forces of supply and demand. This incentive, getting paid the full market value, keeps our economic system innovative, robust, and efficient. This is all well and good except for one key caveat, the fact that there is limited to no competition in providing market data. This lack of competitive pressure has incentivized stock exchanges to extract as much revenue as possible through monopolistic pricing practices while delivering a suite of products that may not be keeping up with technological advancements and market needs. In a 2018 study commissioned by the Danish and Swedish Security Dealers Association, the issue of pricing market data was summarized accordingly:

Market data contains information indispensable for financial market participants to carry out their core business. Data on bids, asks, and last traded price for financial securities (such as equities, fixed income, derivatives, and currencies) enables security dealers to decide which instruments to buy, together with where and when to buy them.<sup>4</sup>

In other words, without market data being readily available, the entire marketplace is at risk. Add to that:

Trading venues have a monopoly on the market data generated on their trading platforms. This provides the major trading with venues extensive market power in selling their market data. Consequently, without effective regulation in place, there is a risk that trading venues will exploit the situation and charge market data fees significantly above the costs of producing such market data.<sup>5</sup>

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<sup>2</sup> IIAC Commentary, Williams, R. Tee, *Through a Glass Darkly – The Death of 1000 Cuts redux*, August 31, 2023, Available at: [https://iiac-accvm.ca/wp-content/uploads/2023/09/Tee-Williams\\_Market-Data\\_Through-a-Glass-Darkly\\_August-31-2023.pdf](https://iiac-accvm.ca/wp-content/uploads/2023/09/Tee-Williams_Market-Data_Through-a-Glass-Darkly_August-31-2023.pdf)

<sup>3</sup> Reports indicate that price markups for market data in the US exchanges have ranged from 500% to 4,200% (see *How Stock Exchanges Abuse Their Privilege and Power for Monopolistic Profits* available at (2019):

<https://www.iex.io/article/how-stock-exchanges-abuse-their-privilege-and-power-for-monopolistic-profits>

<sup>4</sup> Copenhagen Economics, *Pricing of Market Data*, Commissioned by the Danish and Swedish Security Dealers Associations, November 28, 2023, p.6 available at: [pricing-of-market-data.pdf \(copenhageneconomics.com\)](https://www.copenhageneconomics.com/pricing-of-market-data.pdf)

<sup>5</sup> Ibid. at p.6

In this context, and in the absence of a complete overhaul of the market structure and regulatory framework that governs it to allow for greater competition, IIAC views a cost-based approach to pricing as the best alternative to making sure that market data is available and accessible to subscribers. In fact, we support the implementation of a cost-based price cap on market data as recommended by Copenhagen Economics. The benefits of their proposal to the EU market will be applicable to the Canadian market as well.

To recap, and as specified by Copenhagen Economics:

- To regulate and simplify the access and fee structure of market data
- To implement a price cap on market data based on a long run incremental cost (LRIC+) benchmark
- To have a regulatory body (in the Canadian case the CSA) assume a role as supervisor.

### Cost-based Pricing

Under a cost-based price cap, the seller determines the price of the product or service based on the cost of production plus a reasonable profit margin. To be successful, this approach requires an environment of full transparency, where market data providers will have to provide auditable costs related to the production of market data, and the expected profit margin. Information asymmetry between producers and consumers would undermine the validity of this pricing mechanism (hence the need for a capable regulator). When fully implemented, this will lead to the most desirable outcome where both the producers of market data and consumers, and the industry at large will be in a win-win-win situation.

- Consumers win because market data becomes accessible at more reasonable prices, allowing for more market participation;
- Market data providers win because this allows for transparency in the system, which not only builds trust, but allows for a profitable venture through the reasonable profit margin being charged; and
- The Canadian financial market wins because there is now greater transparency and oversight when it comes to one of the key pillars of a healthy and efficient marketplace, eliminates volatility, does not harm liquidity, and does not disadvantage a segment of market participants in favour of another.

Consider the alternative where market data providers continue to pursue profit-maximizing prices in the absence of a price cap. Differential levels of access to market data due to prices have led to different classes of market data consumers. Those who have the resources to pay for the best available bundle of data, and those who rely on lesser quality data. Research supports the notion that this is detrimental to the broader capital market.

Differential access (to market data) generally increases the cost of capital and volatility, reduces market efficiency and liquidity, discourages the production of fundamental information, harms liquidity traders, and benefits rational traders relative to an economy in which all traders observe price data simultaneously.<sup>6</sup>

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<sup>6</sup> Easley, David; O'Hara, Maureen; and Yang, Liyan "Differential Access to Price Information in Financial Markets", *Journal of Financial and Quantitative Analysis*, Vol. 51, No. 4, August 2016, pp. 1071 – 1110.

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A good example is IEX's pricing model for market data and connectivity, designed to be more transparent and cost-effective than other exchanges. IEX operates on a flat fee per share for trading and provides free market data and connectivity for its members up to a certain limit and uses a cost-based approach to charging for real-time data. This approach contrasts with the typical pricing models of other major exchanges, which often involve complex fee structures with various tiers and additional charges for market data and connectivity services.<sup>7</sup> IEX has demonstrated that complete transparency is possible, as they disclose every line item of their market data costs, and fully explain how they arrive at their per-firm pricing. There are no concerns about intellectual property or competitive advantage – market data is a commoditized service and should be treated as such.

In this context, IIAC reiterates its position and calls for the implementation of a cost-based pricing model, full transparency through an auditable cost structure to be provided by market data producers, and regulatory oversight and supervision of market data costs by a capable agency. We believe that this will benefit the industry, including the producers, consumers, and the overall state of the market.

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<sup>7</sup> <https://www.iexexchange.io/resources/trading/fee-schedule>

**IIAC** 

Investment Industry Association of Canada

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**ACCVM**

Association canadienne du commerce des valeurs mobilières

