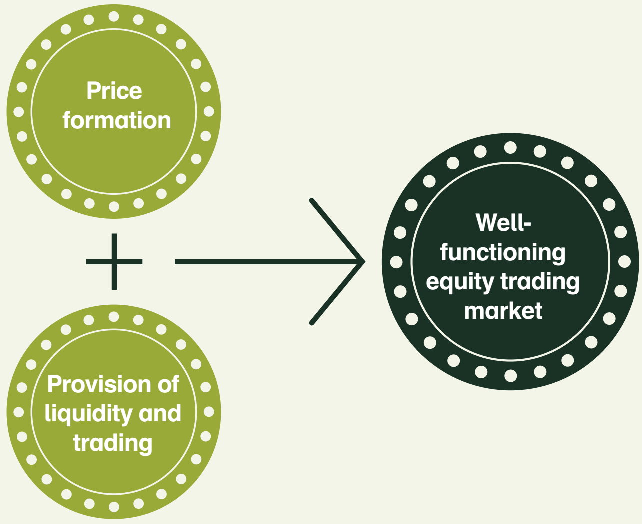
The role of market data in equity trading markets

oxera

Equity markets, where investors buy and sell shares, are crucial to the European economy. Regulatory change has opened up competition, leading to more choice and lower trading fees.

There is an ongoing debate about market data on stock prices.

1. What role does market data play in the design of equity trading markets?
2. How is this market functioning from a public policy perspective?



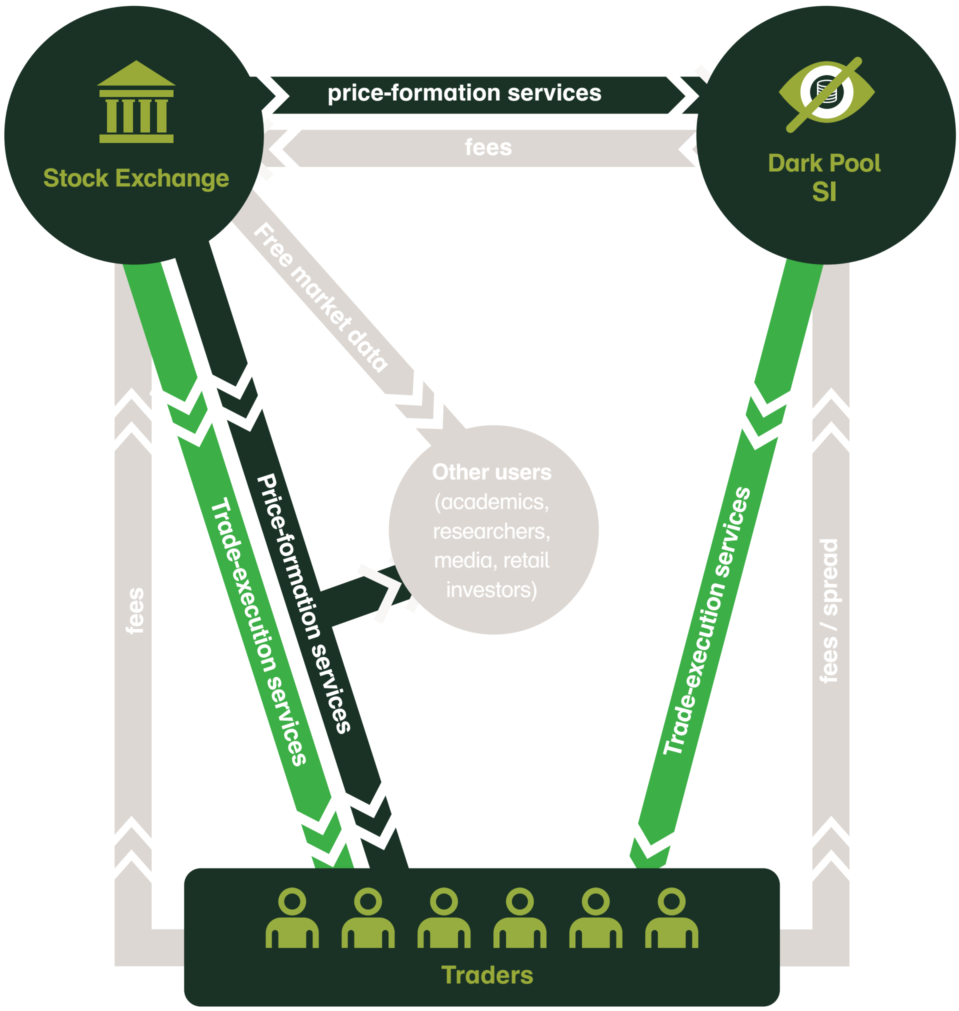
Equity markets are where investors meet (nowadays virtually) to buy and sell shares in a firm. These markets lie at the heart of all modern economies. At the core of these markets is the stock exchange, which creates the market for equity instruments. Indeed, stock exchanges fulfil two core functions in relation to equity trading:

- the provision of trading (or liquidity)—enabling traders to easily buy or sell assets;
- price formation—the process of determining the price of an asset in the marketplace so that participants can make well-informed commercial decisions.

A well-functioning price formation process enables trading to take place and delivers more efficient and fairer markets (which benefits investors), and lowers the costs of capital for businesses.

How does equity trading work today in Europe?

Today, when a broker or investor wants to execute a trade order, it can choose from different venues, such as stock exchanges, multilateral trading facilities (MTFs), dark pools, and systematic internalisers (SIs).



Most new types of trading venue do not deliver price formation, but offer trade execution services by using the price formation delivered by exchanges. Stock exchanges make this available via the licensing of market data, meaning pre- and post-trade information on quotes, orders and execution prices.

Due to this important piece of 'market design', these alternative venues do not need to invest in the systems and human resources required to deliver robust price formation processes themselves, thereby saving costs.

Exchanges and MTFs earn from market data and trading fees rather than from the difference between the bid and ask price (the spread). SIs use market data to deliver trade execution and may not charge an explicit transaction fee but earn the spread.

The role of market data in equity trading markets

Market data is also used by fund managers and brokers to inform trade execution strategies. Other users of market data include index providers, retail investors, regulators and researchers.

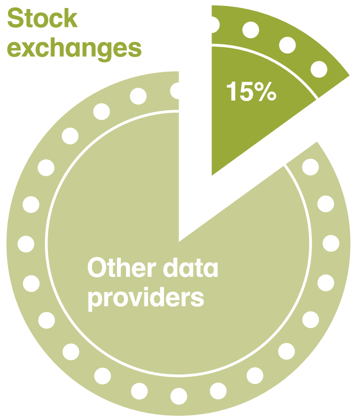
Why do stock exchanges charge for market data?

Data more than 15 minutes old is made available for free to end-users by stock exchanges. This means that retail investors that want to know what their portfolio is worth, fund managers that need to value their funds at the end of the day, and many other professionals that use share prices for financial or economic analysis can receive the high-quality market data from exchanges without paying any exchange fees.

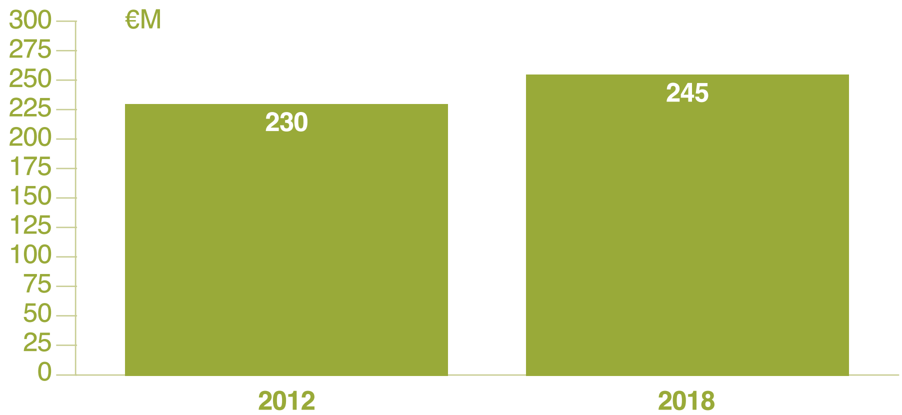
Why do stock exchanges charge for real-time data? There are costs to delivering a high-quality price formation process and, as also explained by ESMA, trade execution and price formation are 'joint products': most activities undertaken by a stock exchange are integral to the delivery of both. This means that it is more efficient to recover some of the costs of operating a trading venue through trade execution fees and some through market data fees.

As a result, a broader group of market participants (i.e. including those that do not trade but do benefit from the price formation process such as SIs and dark pools) contribute to covering some of the costs of price formation.

Market data value chain



MiFID II/R market data revenues



Source: Oxera, based on confidential data from FESE exchanges

Have fees and revenues increased?

Expenditure by fund managers and brokers on market data has increased over time as a result of an upward trend in market data consumption.

However, market data from stock exchanges is only a small subset (around 15%) of all market data that fund managers, brokers and other users purchase.

And, importantly, the total expenditure on stock exchanges' market data fees has remained fairly stable. Last year, all market data users in Europe (i.e. fund managers, brokers, MTFs, SIs, dark pools, etc.) together spent around €245m on cash equity market data from stock exchanges and this has increased by around only 1% per year in real terms.

Are the level of market data fees reasonable?

To assess the level of market data fees, one needs to assess the impact of these fees on market functioning and end-investors. Oxera has analysed this in its report and concludes that there is no impact on market functioning or end-investors.

Most stock exchange revenue continues to come from trade execution fees rather than from market data fees, and the unit costs of equity trading (taking into account both trade execution and market data fees) to end-investors have continued to come down over time in spite of an increase in data consumption.

What do regulators need to do?

The changes brought about by MiFID have been successful in creating more choice in trade execution venues and lower trading fees. At the same time, this has resulted in a smaller proportion of trading taking place on venues that contribute to price formation.

Equity trading markets cannot function without a high-quality price formation process. Therefore, regulatory authorities also need to monitor the balance of trading in 'lit' venues (that contribute to price formation) and other venues such as dark pools and SIs (that do not deliver a price formation process) in order to preserve the quality of price formation, which is ultimately to the benefit of all users of financial markets.