FCA CP on Payments to data providers and forms for DRSPs

AFME Response to FCA Consultation Paper CP23/33

Deadline: 9 February 2024

AFME would like to take the opportunity presented by this Consultation Paper to reiterate that different considerations are relevant to the question of whether data providers should be remunerated for supplying data to the bonds and equities consolidated tapes (CTs). Accordingly, AFME's responses to the below consultation questions should be read as applying only to the bonds CT. AFME understands that the FCA intends to publish further Consultation Papers on the equities CT and intends to expand upon its views on remunerating data providers for the equities CT at the appropriate time.

Question Responses in Chapters 10 and 11

No	Question
1	Do you think any of the three options are preferable to the approach suggested in CP23/15? If not, please explain your response.

Draft response

No, AFME believes that trading venues (TVs) and approved publication arrangements (APAs) should be required to provide data to a consolidated tape provider (CTP) without any associated charges and without participating in any revenue sharing arrangements.

Our rejection of all three options mentioned in CP 23/33 as well as a potential fourth option, based on ongoing revenue sharing, which appears to be under consideration by the FCA, is due to the significant increase in operational cost burden for the CTP, which will be to the detriment of data users (given the CTP will have to charge increased fees to account for this additional cost) and could eventually lead to the failure of the CTP. Our disagreement with any kind of payments to data providers is based on the following:

- **<u>Negative precedent for regulatory compliance</u>**

AFME views deviation from the original FCA proposal (i.e., no payments to data providers) as creating an unprecedented situation whereby TVs and APAs will be rewarded for complying with a regulatory requirement. No other regulated firms are incentivised for meeting the costs associated with their compliance with the regulatory framework. Since the implementation of MiFID II, TVs and APAs have come under greater regulatory scrutiny with respect to their obligations to ensure the integrity of the data they handle as well as the methods for making those data available to the public. In this respect, AFME members' think that achieving high quality of reported data on behalf of data providers can be better achieved through appropriate supervision of those firms and enforcement of the current rules (which have been in place for the past 6 years) and not by means of additional payments/rewards for complying with regulatory obligations in the form of unilateral cross-industry subsidisation of data providers.

Consequently, the reference to payments to data providers providing an incentive to comply with something that is already mandated by law is surprising and will set a negative precedent.

As documented in **FCA Market watch 72**, an aligned approach to data quality across APA's would seem an initial starting point, given that the report states

> *"APAs are required to have arrangements to identify trade reports that are incomplete or contain information that is likely to be erroneous. We have observed differences in how APAs have interpreted a trade report 'that is likely to be erroneous.*"

Therefore, in view of the divergent approaches among data providers and the identified gaps in relation to applicable quality standards, shifting the focus from enforcing the required levels of quality of reported data to financial incentives, could give an incorrect signal that data providers should bear no liability for their compliance costs.

- **No material costs or revenue losses for data providers**

AFME members think that there is strong evidence from available market data (including among others the FCA's MS23/1.4 Update Report) and publicly available financial information which demonstrates that market size and revenues of data providers are more than adequate to absorb connection costs to a CTP. In particular, firms operating both as APAs and TVs have an average market capitalisation of approximately USD 15.6 billion and have stated in their publicly available annual reports total revenues in 2022 of approximately USD 960 million on average). On this basis, any payments to data providers will not deliver any meaningful impact to them, but will instead disproportionately burden the CTP and could be a contributing factor that will prevent prospective CTPs from participating in the tender process.

Furthermore, TVs and APAs will not suffer any revenue losses as a result of the consolidation of MiFID/MiFIR trade transparency data through the operation of the CT. In particular, revenues for TVs from these market data represent only a very small part of their total business revenues (e.g. for one TV they were less than 1%) and overall their revenue streams are generated through other means which primarily include the sale of price discovery data to investment firms. With respect to APAs, given that their function is to report the market data provided to them from investment firms (i.e. the original generators of market data), claiming authority over market data or the ability to resell and participate in business revenues from them, is not a viable argument as currently (as per our understanding) no APA firm is doing so.

- **Negative impact on the viability of CT**

As highlighted in AFME's Response to FCA Consultation Paper CP23/15, contribution of data should be mandatory and not chargeable, in order to ensure that a CT remains a viable commercial enterprise for CTPs. The success of a CT will be an important step for making data available to all and thus make financial markets more accessible and transparent. However, the increased costs will undermine these goals as the CTP (if it must recompense TVs and APAs) will essentially have no other choice than to price its services at a level that many data users will not afford to use them. Therefore, if access to a CT becomes too expensive, it will be unlikely to attract users and there is a high probability that the CTP business will fail.

- **Negative impact on the international competitiveness of UK financial markets**

AFME members believe the development of a successful CTP model should not be addressed in isolation from FCA objectives to promote competition for the provision of market data and international competitiveness of the UK economy. Were the CTPs venture to become unsuccessful, as a result of increased costs incurred, due to any of the three options proposed in CP 23/33, the knock-on effects and particularly the impact on the attractiveness of UK financial markets could be considerable. Therefore, there needs to be careful consideration of any side effects that a model relying on payments to data providers can cause in view of the international outlook of UK's economy.

AFME members are also concerned that at the time of this submission it is unclear whether there is strong interest by prospective bidders to assume the role of a CTP, which is an alarming warning that imposing high costs to the business model of CTP will undermine the efforts for developing a successful CT.

- **Risk that data providers will increase costs for market participants**

Finally, AFME notes that none of the options preclude APAs and TVs from using their powerful position in the market to renegotiate their agreements with investment firms and include additional costs (on top of what they are currently charging, for example some APAs charge to make corrections to post-trade submissions, as well as for rejecting trades as a result of a data quality issue that has been identified). The non-sharing of CTPs revenues by data providers should therefore not be used as a justification for passing unsubstantiated costs to other market participants and the FCA should be cautious of any such attempts.

No	Question
2	If you think that payments should be made to data providers, do you support any of the options we have proposed for calculating the payments to be made? If not, please explain your alternative approach.

Draft response

AFME does not support any of the options presented in CP 23/33. AFME supports the FCA's original proposal (from CP23/15) that there should be no payments to data providers. AFME members strongly believe there remain no circumstances that justify payments to TVs and APAs for connection to the CT, or the introduction of any revenue sharing mechanism.

The anticipated profits from increased trading activity and overall market growth due to the operation of the CT (particularly for TVs) will outweigh any rebate that data providers would seek to derive through their participation in the revenues/income of the CTP and can adequately off-set any connectivity costs. In particular, according to the financial reports of the leading data providers, the vast majority of their revenues is from pricing data while the contribution of MiFID/MiFIR market data to their revenue streams is minimal at best. Therefore, any request to extract additional benefits by participating in CTPs revenues and thus, hampering the ability of a CTP to operate its business in a commercially viable way, sounds unreasonable. For the same reason, it will not be justified for data providers to try to increase fees in their agreements with investment firms for allegedly reduced revenues from MiFID/MiFIR transparency data, when the impact of such data on their revenues is negligible.

To support the above, please see below our analysis which explains why none of the proposed options in CP 23/33, including ongoing revenue sharing are viable:

<u>Option 1</u>: This option will require a fixed sum to be paid to each data provider. Although it appears simple in its conception, it can lead to unreasonable solutions. For example, large TVs which generate sufficient revenues and profits from a diversified client base and geography and are in a position to achieve economies of scale due to their organisational model and effectively reduce any costs for connectivity with the CTP, will be paid the same amount as data providers who only have a very small market share and are active only in certain market segments. Thus, a fixed amount in the range of GBP 58,500 is highly unlikely to deliver any substantive benefit for those data providers who share the majority of the market given their overall income generation streams. On the other hand, the cost for the CTP will be material as the total amount to be distributed to all data providers can add up to a large figure, even though each data provider will only receive an incremental slice of it. Thus, this model will disproportionally burden the CTP without delivering any substantive benefit.

<u>Option 2</u>: As the cost exposure of the CTP through this model will be unknown and uncapped, the CTP will need to ensure that there will be sufficient provisions to cover the relevant amounts that will eventually be paid to data providers. In addition, the requirement for payments to be paid in only two installments can be detrimental to the ability of the CTP to meet its other obligations as they fall due. AFME members believe that whilst this may seem a fairer approach, the complexity and inherent risks of this option will add additional obstacles to prospective bidders, who as a result may decide to stay away from the tender process. <u>Option 3</u>: This option refers to ringfencing of revenues. To avoid significant costs being passed onto the end user, profits rather than revenue should be considered. At least for the first two years of a CT's operation, the CTP will have to meet an increased number of operating expenses which might in turn prevent its ability to generate any profit (please also refer to the Adamantia feasibility study on the European Fixed Income Consolidated Tape according to which costs are expected to reach their peak in year 2, before being progressively recouped by revenues). Therefore, ringfencing of revenues in order to return to data providers at least 20% as proposed in CP 23/33 will have no other result than to drive up the costs for users accessing the CT. This option also fails to consider any newly authorised DRSPs that starts providing data in the time between the second CTP payment (24 months from operation) and the 18 months before the expiry of the tender. The second payment would have distributed the proposed 20% share of revenue. Any new DRSPs authorized after this date would result in a greater percentage of revenue share than has been ringfenced. <u>Option 4</u>: In view of some recent industry discussions with the FCA for the potential introduction of an ongoing revenue sharing requirement, AFME members express their objection to any such option which essentially deprives the CTP of the ability to recover costs before the tender term finishes. In a recent feasibility study conducted by Adamantia Advisory, it was demonstrated that a break-even of costs and revenues is only expected later in the CTs operation. Therefore, by mandatorily extracting part of the CTP's revenues for the benefit of data providers (and thus creating large deficits for the CTP's business), cost recovery will become challenging. In turn, there will be little valid business case for prospective bidders to participate in the CTP tender process should recurring revenue sharing be introduced. In addition, none of the proposed options address any complexities that may arise if new data providers join the CTP after its commencement, or data providers cease to operate at any time during the initial 5-year period of the CT. In those situations, the CTP will be exposed to additional costs towards new joiners which will not have been known and included in its financial analysis at the time of bidding. It is also doubtful whether a CTP will be entitled to recover payments from data providers that no longer participate in the CT.

No	Question
3	If you think that payments should be made to data providers, do you think that those payments should be conditioned on data quality? If so, please explain any suggestions you have for measuring data quality.

Draft response
AFME members disagree with any payments to data providers and reiterate the fact that the existing regulatory framework already imposes obligations about maintaining quality of data. Therefore, the discussion on using payments to data providers as an incentive for data quality is irrelevant. Given the identified data quality issues, AFME members are concerned about any detrimental effect to the CT due to a lack of a uniform approach with respect to data quality. For instance, although there are already

provisions in the existing legal framework for machine readable public data, not all data providers implement this requirement effectively. Thus, the operation of a CT will commence from a disadvantageous position to that intended and the CTP will have to ensure that an appropriate API will be in place to facilitate adequate data quality for all connected TVs and APAs.

This highlights the need to prioritise data quality and ensure compliance of data providers with their obligations, under the current laws and regulations. For this reason, AFME members would welcome more clarity from the FCA on determining criteria for adequacy of quality checks and controls on reference data, both those to be reported under MiFID/MiFIR rules as well as data in the context of unregulated services offered by data providers.

No	Question
4	Do you think that in Option 1 we have set an appropriate level of payment?

Draft response

As highlighted above, AFME do not support any of the options. Under no circumstances should the CTP be required to make payments to data providers.

In particular, with respect to the proposed amount of compensation set out in Option 1, it is likely that a fixed sum which is the same for all data providers will result in unfair outcomes, given the capacity of large data providers (in which most of the business is concentrated) to absorb any costs associated with connection to a CTP's API.

In contrast, the total amount that the CTP will be called upon to pay to all data providers can be material to the viability of its business, given that during the first years of operation it is anticipated that there will be considerable operating expenses, and likely no profits generated.

No	Question
5	Do you think that in Option 2 there should be a requirement for external auditors to review the cost methodology and the costs? Do you have a view on the costs presented in the cost benefit analysis of this obligation?

Draft response

Although AFME disagrees with Option 2 and does not recommend any of the proposed options, should the FCA decide to adopt a cost rebate mechanism, this needs to be based on a requirement for an external audit. This will ensure that data providers do not technically inflate costs (e.g. by hiring external consultants and then passing on the costs), and will not be able to recover any costs that are not directly associated with and are not absolutely necessary for connection with the CT. Furthermore, in view of the current market structure and levels of concentration within it, market operators who have established and operate trading venues as well as APAs operate through multiple entities, and have the operational capacity to build-up the technology for connecting to the CTPs API once and then cascade across the whole group in order to achieve economies of scale.

The verification by an individual third party will ensure that only the costs that have been accurately identified and attributed to the connection to a CTP will be compensated and only up to a reasonable level. Data providers which are part of the same group of companies or are affiliated entities are able to achieve economies of scale and share technology and infrastructure with respect to their connectivity to a CTP, and thus minimise expenditure. Therefore, an audit should factor in this element, and adjust costs accordingly.

Moreover, adequate arrangements should be put in place that will prohibit data providers from recovering audit costs or costs in excesses of a 50% cap as proposed in the CP from other market participants, such as passing those costs to investment firms that contribute reporting data as part of their trading activity.

No	Question
6	Do you have any comments on the level of X in Option 3, including views on how it should be set?
Draft response	
As already expressed in AFME's Response to FCA Consultation Paper CP23/15, a Bond CTP should <u>not</u> have a revenue sharing mechanism and AFME continues to strongly disagree with any suggestion for compensation of data providers in the form of revenue sharing. This third option, which is not based on the cost of connection but rather the success of the bond CT, could dissuade potential CTPs from participating in the tender as it makes financial planning impossible. In particular, the CTP will not be able to determine at the time of bidding the number of data providers entitled to revenues, and this uncertainty will be recurrent throughout a significant period of the first CT, as new data providers can join at any time up until 18 months before the expiry of the tender contract term. As the newly joining DRSPs will also be entitled to revenues, the CTP will have to set aside additional portions of revenues, because the initially created fund comprising revenues from sales of the first 12 months of a CT's operation will have already been exhausted and distributed after 24 months. Further, for newly joining DRSPs which connect to the CT by the final cut-off time, there will not be sufficient time for the CTP to measure whether those joiners have met the quality standards on which payments to them are conditional. Eventually, the CTP will have an ongoing liability to top-up the fund aimed to cover the payments to data providers which will make projections for cost recovery timeframes impossible. In addition to the above, it is also highlighted that the introduction of a bond CT would not result in a revenue loss that data providers need to be compensated for. There is also no valid reason that could justify ringfencing of revenues for the benefit of data providers while at the same time exposing the rest of the CTP's creditors to the risk of not being paid. Furthermore, as highlighted in our response to question 2 above, by referring to revenues instead of profits option 3 fails to tie any cost recovery with the CTP's success and its ability to pay. This option will deprive a CTP from resources which are particularly important for the first years of operation, as the more revenues the CTP will generate, the greater the portion to be extracted by data providers will be. For this reason, there should be no requirement for ringfencing of revenues.	

No	Question
7	If we proceed with Option 3, should we set an upper limit on the level of payments?
Draft response	
AFME members disagree with setting any predetermined amounts of payments to data providers. Cost recovery under Option 3 should only be made possible if the CTP is in a position to generate profits. The focus should be the attractiveness of a CT which will require competitive pricing, in order to enable access to data for as many market participants as possible and promote the increase of trading activity (which, among other market participants, will also benefit TVs). Consequently, if the FCA were to proceed to an option requiring ringfencing of revenues, with which AFME members strongly disagrees, the upper limit would have to be set to the lowest possible level given the side effects that any such option could cause. Please also refer to our response to question 6 above.	

No	Question

8	Do you have any comments on the forms for DRSPs that we are proposing to include in MAR 9?
Draft response	
AFME will not be answering this question.	

Question Responses in Annex 3

No	Question
1	Do you have any comments on our cost benefit analysis of payments for data providers by the CTP?
Draft response	
As a general remark, AFME members believe that any of the proposed options for payments to data providers will disproportionately worsen the position of the CTP and data users. At the same time, it will deliver benefits to data providers that would not normally be expected to be obtained, in the form of subsidies for their compliance with the existing regulatory framework. This point is missed in the cost benefit analysis in Annex 3 of CP 23/33, which overall has a single-minded focus towards data providers and omits any consideration of negative effects for all other market participants. <u>Option 1</u>: By setting a pre-determined amount to be recovered by data providers before connection to CTP is implemented, there is a possibility that any connectivity costs are actually lower than the original determination of £1.23m made in CP 23/33. Therefore, large data providers that can secure connectivity at a very low cost, or at only a negligible cost might extract additional benefits to the detriment of the CTP. On the other hand, the costs for the CTP might be well above the estimated figure given the CTP will also have to make sufficient provisions for new data providers that will join the CT at a later stage and will still be entitled to payments. Therefore, the CTP will have to submit a bid during the tender process to reflect the above, and might have to increase the fees that data users pay if it has anticipated several new data providers will join the CT at a later stage. As the price for access to the CT will increase, the demand for the CT by end users will decline and might ultimately cause the failure of the CT as a source of market transparency, in favour of other options. If the issues raised under our response to question 1 are not addressed, it is unlikely that the users of the CT will actually benefit from any improvements in data quality. <u>Option 2</u>: This option relies on a very wide estimate of costs (currently £0.8m - £1.65m million) although it is clear for the reasons mentioned in our response to question 5 that there might be incentives for data providers to charge amounts above this projected range, as there is no cap on the level of costs and expenses they are allowed to charge for their connection to the CT. Further, the level of costs for the CTP will be unknown until the end of the term of the contract as the CTP will have to make considerable provisions to meet its payment obligations towards new joiners, and the uncertainty around the amount to be compensated will remain until an audit has taken place. Again, the effect on end users will be negative and will be reflected in a higher cost for them, as the CTP will have to factor this uncertainty into its bidding as well as its proposed fees. As also mentioned above, neither the CTP nor data users will be able to benefit from improved data quality, as suggested in the FCA's cost benefit analysis, without first addressing the other issues identified in our response to question 1. <u>Option 3</u>: This option seems to unnecessarily increase the costs for the CTP, as its revenue stream will need to be sufficient to satisfy obligations towards data providers on an ongoing basis and cover for any top-up of the funds which, due to the nature of it being ringfenced could in the case of a credit event mean that creditors of the CTP do not get paid. Furthermore, it is likely that this scenario could lead to worse economic terms in the contracts of a CTP with other vendors/suppliers who will seek additional assurances. All these costs will be reflected in the fees offered to end users, which will essentially have to be increased for these	

reasons. Similarly, the CTP and data users will not be able to realise any benefits from higher quality of data, as previously explained.

Option 4: Data providers will have an unfair competitive advantage over the CTP: on the one hand they will benefit from an additional pool of revenues provided by the CTP, while on the other they will continue deriving profits from all their existing sources of income without suffering any reductions to them. In addition, it is highly likely that their existing revenues will increase as a result of larger trading volumes due to the existence of a CT, and thus they will gain an additional benefit on top of their participation in the CTP's revenues. At the same time, the CTP and data users will have to incur additional costs to cover the revenue based payments to data providers.

Finally, for all of the options above, the FCA has failed to address the consequences of a potential failure of a CTP's business (e.g. costs for running a new tender if the CTP resigns due to the inability of cost recovery, and the effects on UK financial markets if no bidders participate in such new tender due to the negative precedent that the previous failure of the CTP will have set).

No	**Question**
2	Do you have any comments on our cost benefit analysis of forms for DRSPs?
Draft response	
AFME will not be answering this question.	