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Ontario Securities Commission

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RE: CSA Consultation Paper 21-403 – Access to Real-Time Market Data

The Canadian Security Traders Association, Inc (CSTA). is a professional trade organization that works to improve the ethics, business standards and working environment for members who are engaged in the buying, selling, and trading of securities (mainly equities). The CSTA represents over 850 members nationwide and is led by Governors from each of four distinct regions (Toronto, Montreal, Prairies and Vancouver). The organization was founded in 2000 to serve as a national voice for our affiliate organizations. The CSTA is also affiliated with the Security Traders Association (STA) in the United States of America, which has approximately 4,200 members globally, making it the largest organization of its kind in the world. This letter was prepared by CSTA Trading Issues Committee (TIC) representatives with various areas of market structure expertise. It is important to note that there was no survey sent to our members to determine popular opinion. The views and statements provided below do not necessarily reflect those of all CSTA members or of their employers.

The TIC appreciates the opportunity to comment on the CSA consultation paper discussing access to real-time market data (RTMD). We commend the CSA for conducting such an extensive fact-finding review and for publishing its work.

The automation of equity trading combined with the fragmentation of trading across multiple marketplaces has increased the quantity of RTMD necessary to quote and trade securities. Over time, greater processing power has enabled the automation of trading. Portfolio trading, ETFs, and algorithmic trading strategies such VWAP are all examples of automated trading approaches that are large consumers of RTMD. As trading became more automated, the fragmentation of the trading ecosystem from a single marketplace to a multi-marketplace ecosystem increased the breadth of data available. Taken together, the quantity of RTMD required to implement an institutional order today is far greater than it was 20 years ago.

As the trading ecosystem evolved, competition for trades increased and trading fees naturally went down; however, RTMD fees have gone up. This outcome is counter intuitive. Typically, in economics one would associate more technological innovation and more competition with lower costs not higher costs. We believe the rising cost of market data is evidence of the captive consumer problem faced by the institutional equity community. Traders require a complete picture of their trading ecosystem to quote and trade securities. Thus, traders have inelastic demand for RTMD. Furthermore, as the consultation paper notes, Canadian marketplaces enjoy a de facto regulatory subsidy over the sale of their data since traders are compelled to buy it for best-execution and order protection compliance purposes.

Our equity market structure has evolved to produce very competitive outcomes for trades, but very uncompetitive and even monopolistic outcomes for RTMD. Thus, it can be argued that regulatory intervention is needed to deliver fair outcomes for consumers of RTMD. Our members were generally in agreement with the findings of the consultation paper, and we believe the total cost associated with the consumption of RTMD is too high. The challenge now is what to do about it. We believe our industry has two options to consider:

1) Regulate marketplaces like utilities. Calculate a fair return for marketplaces and allocate RTMD fees based on a new more holistic data-fee model (DFM) which covers the totality of market data needs, and not only professional subscriber fees.
2) Directly address the captive consumer issue faced by institutional traders, encourage more competition amongst marketplaces and create a SIP like model for indicative users.

Our members are divided on which option is best. Some members favour option 1 and others favour option 2. Those that favour option 1 believe it is the more pragmatic approach to lower RTMD costs. Those that favour option 2 believe the regulatory intervention necessary to fairly price RTMD is a step too far for regulators to take and instead favour addressing the root cause of the issue – a lack of competition. Simply put, Canada, like many other countries, has too many marketplaces offering very similar services and all of them charge for RTMD.

Below are the answers to Questions 1-24

QUESTION #1: Please identify any potential unintended consequences at the industry, marketplace, or firm level if we pursue this option.

Marketplaces might be sensitive about their costs being disclosed to their competitors, especially in advance of implanting a new product or service.

Over the long-term, innovation might be at risk as consumers of RTMD may simply prefer the status quo. Consumers of RTMD might be unable to predict the benefits of new technology, especially when such technology threatens existing businesses, requires upfront investment, or applies to only a subset of users.

QUESTION #2: Would this approach satisfy the need for more transparency in relation to proposed fee changes and their review process? If yes, please indicate what benefits this approach would offer. If no, please explain why and whether other requirements should be considered.

Despite the risks noted above, we are supportive of a more transparent fee approval process. Over time, it is likely that new fees will be proposed by marketplaces that were previously out of scope of the DFM. If regulators adopt a new DFM, full transparency of any new fee change will become even more important.

QUESTION #3: What are your concerns, if any, with continuing to use the DFM? If the DFM were to continue to be used, what changes are necessary?

There is no obvious benchmark or reference point that currently exists to value RTMD. Marketplaces, like many other software companies, typically operate very scalable business models. Software companies tend to have high fixed costs during the startup phase as the software is written and the business is launched, but very low variable costs as the business matures and users are added. Hence their profits tend to scale very well. Regulators around the globe are struggling with this issue. We all agree monopolistic profits are suboptimal for consumers, but price setting and too much regulation may also deter future investment. Innovation requires capital and capital follows investment returns. If regulators decide to pursue option 1, it is imperative they strike the correct balance.

Determining a suitable reference point will be a challenge for regulators. Some of our members believe the current benchmark is not representative of the value of Canadian RTMD and suggest comparing Canadian data fees to Deutsche Bourse and the German marketplace instead of the US marketplaces. Regardless of the benchmark or reference point chosen, our members generally agree the cost of RTMD in Canada is too high. The challenge for regulators is how to find the “correct” price.

We believe the most informative way to group consumers of RTMD is not by the type of subscriber (professional/non-professional), but by examining how the data is used. We see two groups of users. The first group purchases RTMD for order routing and trade execution purposes (likely a subset of professional users). The second group purchases RTMD for indicative purposes. Retail traders, Wealth Advisers, analytics providers, and any human eyeballs would all be in the second group. Regulators should apply the new DFM only to this second group of users.

Despite the challenges noted above, if regulators are going to reduce the cost of RTMD, a new DFM is probably necessary. If competition is used to lower data costs for professional users who route and execute orders, than the DFM should be used to lower costs for all indicative users. This would reduce the scope of DFM project to only look at level 1 or top of book data. Rather than ask each subscriber to negotiate their own agreement, the new Information Processor would be better positioned to negotiate all costs related to the consolidation, distribution, and consumption of indicative data. This approach would meaningfully reduce the administrative burden for small investors, international investors and analytics providers who only require consolidated data for indicative purposes.

The new data-fee model could be used as a tool by the TIP+ administrator to help negotiate a fair price for consolidated RTMD. The new TIP+ would have strong negotiating power, since it would be the largest buyer of RTMD data. Since the data would be used for indicative purposes only, latency concerns arising from the consolidation of data should be minimal. The TIP+ would be well positioned to negotiate netting agreements for large bulk buyers of data and it could also negotiate smarter licensing agreements, effectively allowing for the portability of data per user across many applications. Finally, since the marginal cost of signing a new data subscriber is essentially zero, it is reasonable to expect most marketplaces would be willing to reduce their data fees if they could gain more subscribers (lower price, but higher quantity of users).

The SEC is proposing a series of new sub-penny quoting and trading increments for NMS securities, including many Canadian issuers. If these reforms are approved, it is useful to anticipate how this might impact trading in Canada. As the tick size narrows, OPR will force traders to route orders away to other marketplaces for a fraction of a penny (as little at 10 mills). This will pose a challenge for many institutional traders looking to execute larger sized orders. It is not unreasonable to expect the message traffic to increase substantially in sub-penny regime. In this new regime, it may be more advantageous for some traders to forgo the latency associated with routing to away marketplaces and instead concentrate their efforts on the existing marketplace. In a sub-penny world, the order protection rule may become less relevant.

Thus, we are recommending a two-pronged approach to bring down market data costs. For traders who route and execute orders, the solution is to create better competition amongst marketplaces. For the more indicative users, such as Retail traders, Wealth Advisors and analytics providers, the solution is to create a new SIP like Information Processor or TIP+ to negotiate, consolidate and distribute RTMD.

QUESTION #4: Is the application of the DFM appropriate for both senior and venture market data?

Yes. The DFM should apply a separate formula for junior marketplaces. For example, small cap listings tend to have wider spreads and lower volume. If the DFM rewards quoting and trading equally, it might unintentionally penalize marketplaces with a higher proportion of small cap listings.

QUESTION #5: Should the application of the DFM be extended beyond subscriber fees? For example, should the DFM be applied to non-display and distribution fees (whether internal and/or external distribution fees) given the potential challenges noted above?

Members are mixed on this question. Those who favour option 1 believe regulators should blanket all data costs into a utility like framework for all users.

Those who favour option 2 believe the scope of the DFM should be more limited. Under option 2, the DFM focuses on allocating the TIP+ revenue from indicative users back to marketplaces in a way that rewards the characteristics of market quality.

QUESTION #6: What are the potential benefits or risks of making the fee ranges calculated under the DFM transparent? Should there be greater transparency of other inputs to the DFM (e.g., reference points or key input metrics)? If so, please comment on the potential benefits and risks.

Fee ranges can be transparent if the DFM is limited to indicative users of level 1 data via the new TIP+ administrator.

QUESTION #7: Should we consider adopting a methodology for non-professional subscriber fees? If yes, what should be factored into such a methodology? If not, why not?

Yes. The data fee model should be used by the TIP+ administrator who will serve all indicative users, including non-professional subscribers. Non-professional subscribers consume market data in a very different way than those who route and trade securities. Non-professionals aren’t likely to directly contribute to price discovery, but they are large benefactors of the price discovery of other traders.

Thus, the value of RTMD to these non-professionals and to all indicative users more broadly, is much lower than it is to those who execute trades.

The mechanics of the new data fee model deserve a separate consultation paper and comment process. Any changes to the data fee model scope, definitions and formulas will be highly controversial since some marketplaces should reasonably be expected to be impacted more than others. A simple 50/50 split across quotes and trades is probably insufficient to fairly allocate data fees.

At a high level, the new DFM should allocate RTMD fees across marketplaces based on observable characteristics of market quality. Market quality should be assessed per security and then aggregated for each order book within each marketplace. Factors to consider include orders that set the NBBO, orders that tighten the bid/ask spread, the duration of orders that set the NBBO, the ratio of orders that lead to trades, the ratio of orders that are canceled and never filled, order size, depth of book amongst others. It is not obvious to us what metrics should be included in a new DFM, and more importantly, what influence or weight each metric should carry in the formula.

QUESTION #8: Should we standardized key terms and definitions, such as professional and non-professional users, be developed for the access to, receipt, distribution, and use of RTMD products? If yes, please explain what the benefits of such an approach would be. If not, please explain why not.

We agree the needs of non-professional vs professional users are different. However, we think it is better to group users based on what they do rather than who they are. For example, some professional users would consume RTMD for order routing and trading purposes, but most professional users are likely still “eyeball” users and hence they probably have more in common with non-professional users. We propose two groups of RTMD users 1) those who route and execute orders and 2) all other indicative use cases.

We would resist the urge to standardize key terms and definitions as much as possible. Standardizing terms and definitions is difficult to get right and may set the stage for future regulatory arbitrage (i.e., it may incentivize marketplaces to structure products and fees out of scope).

QUESTION #9: What other key terms and definitions should be standardized? What factors or industry legacy issues should be considered in standardizing such terms?

As few as possible.

QUESTION #10: Would this approach help address market participants’ concerns with respect to the administrative burden related to the access to and use of consolidated RTMD? Please explain your answer.

See our answer to question 3.

QUESTION #11: What would be the unintended consequences, if any, of standardizing these types of key RTMD terms and definitions?

Appling an overly prescriptive regulatory process may incentivize marketplaces to create products and charge fees that are out of scope (i.e., it may lead to regulatory arbitrage).

QUESTION #12: Would caps on fees charged by marketplaces for their RTMD consumed through the consolidated TIP products affect the consumption and use of consolidated RTMD? If so, how? If not, why not, and are there alternatives that should be considered?

Difficult to say. It is our understanding that many large indicative users of RTMD have negotiated their own enterprise level agreements which may provide discounts based on the number of users. Caps on the fees charged by other marketplaces may successfully lower the cost of buying consolidated data, but it none-the-less would remain an incremental cost for any users of primary market data only. Regulators will need to mandate the use of consolidated RTMD before widespread adoption occurs.

As discussed in our response to question 3, if the new TIP+ administrator can increase the quantity of users, there may be an opportunity to negotiate lower fees per user from most marketplaces (i.e., lower fee, more users = smaller drop in revenue). The challenge will be negotiating lower fees from the primary marketplace so that the incremental cost of consolidated data is lower than what folks already pay now for the primary marketplace

QUESTION #13: Under this approach, do you believe data vendors would begin to offer TIP-based products and pass cost savings on to the end user? If not, what drivers would be necessary to encourage this? Do you envision any potential unintended consequences under this approach?

No. As noted in the consultation paper, a TIP-based approach would merely pass on high costs to users. The administrator of the TIP would need to be empowered to negotiate lower costs for indicative users, likely through the application of a new DFM.

To help reduce costs, regulators could create a competitive bidding process where marketplaces and third-party vendors compete for the administration of the TIP+ consolidator. Since most users are indicative users, we don't see the need for competing consolidators (there should be minimal latency concerns).

QUESTION #14: What means of establishing caps and what factors for establishing cap levels should be considered?

The data fee model should be the primary means used to negotiate any fee cap. In many countries RTMD is sold under monopolistic conditions to a captive consumer. Simply referencing or benchmarking Canadian costs to costs elsewhere is probably insufficient to find the "correct" price.

The challenge for regulators is coming up with a more suitable reference point or benchmark of comparison. To calculate a fair price of RTMD, regulators will need to estimate the value of RTMD. This is problematic since value is inherently subjective and based on each brokers unique preferences and business model. For example, the value of RTMD to a market maker and the value of RTMD to an Investment Advisor or a Retail broker is very different. Thus, regulators will be challenged to put a price on the value of RTMD without also picking winners and losers and rewarding some business models more than others.

QUESTION #15: What are your views on the appropriateness of an Admin IP model for Canada? What would be the key benefits and challenges and how could any challenges be addressed?

We are supportive of an Admin IP model for Canada, but only for non-execution users or what we call indicative users.

An Admin IP should be able to negotiate cheap, consolidated, and easily accessible data to all indicative users. The Admin IP will become the largest buyer of consolidated RTMD in Canada. A single large buyer, supported by a well-designed DFM, should have considerable negotiating power compared to a single consumer without a DFM. In addition to lower costs, an Admin IP would provide a single access point for consolidated data with a single user agreement, relieving much of the administrative burden. The value of RTMD decays rapidly with the timeliness of the data. If the Canadian Admin IP provides only indicative data, the cost of such data ought to be much lower than the timelier direct feeds used for execution purposes. Finally, since the Admin IP will be designed for non-execution purposes, the construction and any associated latency ought to be less of a concern than a US style SIP (which serves both trading and indicative users).

QUESTION #16: What are the unintended consequences or risks that should be considered?

Adopting a US style SIP in Canada is likely to bring latency issues as well as governance issues with it. Marketplaces should not have oversight over the product they sell. Regulators should maintain control over the governance of the Admin IP. If the Admin IP is also used for order routing and trading purposes, marketplaces may have an incentive to allow the quality of the Admin IP to deteriorate in favour of their more expensive direct feeds. The new Admin IP should avoid these issues by only serving indicative users.

QUESTION #17: Are there any other key responsibilities that should be considered for an Admin IP model?

See question 15

QUESTION #18: What governance model could be introduced that would be fair and help overcome conflicts such that the Admin IP could achieve its regulatory obligations?

Regulators should maintain control over the DFM and oversight of the Admin IP

QUESTION #19: Based on the size and scale of the Canadian market, should the CSA consider allowing for multiple TIPs to operate under the Admin IP approach?

No. There is no need for competing consolidators. Firms can compete and bid for the rights to run a single Admin IP and TIP (aka TIP+), but since the TIP+ would effectively be a regulated utility we only need one firm to run it.

QUESTION #20: Alternatively, should there only be a single TIP and, if so, should it be operated independently of the Admin IP?

The Admin IP and the TIP should be fused into a TIP+ model where regulators maintain control over the DFM and the governance of the TIP+ but allow a third party to negotiate the price paid for RTMD, consolidate the data, and distribute the data.

QUESTION #21: If there is only a single TIP, should it operate as a for profit business or as a not-for-profit entity? Please explain your answer. 7.3 General Questions

For profit firms should compete and bid for the rights to run the TIP+. Compensation should be designed to encourage the administrator to negotiate the best terms and pass back most of the cost savings to users (less a small spread for the effort).

QUESTION #22: With respect to Staff Consideration 1, do you think that our review of RTMD costs and accessibility should consider the impact of regulatory requirements, such as OPR and best execution? What could drive changes in consumer behaviour (such as disconnecting from marketplaces that offer little benefit to the market compared with the costs or unprotected marketplaces)? What changes could impact the competition among data producers? What could incrementally increase consumer bargaining power? And ultimately, could any of these suggestions impact fees? Please explain your answer.

Yes. See our answer to question 3.

QUESTION #23: Would any of the options outlined above assist dealers with moving retail orders to other marketplaces during a marketplace outage? B.1: Notices November 10, 2022 (2022), 45 OSCB 9504

No. Our understanding is that marketplaces freeze orders during a disconnect and brokers can't move orders until they receive an acknowledgement on their cancelation message.

QUESTION #24: Are there any other options to address industry's concerns about the access to and cost of RTMD that we have not considered? Please explain your answer.

We see two very different options for regulators to consider. Our members are divided on which approach is best.

1) Regulate marketplaces like utilities. Calculate a fair return for marketplaces and allocate RTMD fees based on a new more holistic data-fee model (DFM) which covers the totality of market data needs, and not only professional subscriber fees.
2) Directly address the captive consumer issue faced by institutional traders, encourage more competition amongst marketplaces and create a SIP like model for indicative users.

The CSTA TIC believes we all have a collective interest to protect and preserve a Canadian equity market that is fair and efficient for everyone. We are deeply aware that not only is there no single path toward this goal, even if there were it is unlikely that a single group of stakeholders would know the way. Instead, the CSTA TIC believes it is better to create a regime that allows for individual marketplaces to innovate, compete for order flow and if necessary, even fail. Indeed, within reason, the invisible hand ought to dictate what business models succeed and what business models fail. Based on our interpretation of the consultation paper, it appears regulators are leaning towards a regulated utility model. Many of our members support this approach. However, it is less clear to us how this approach should be implemented, and the devil is always in the details. Those of us that favour option 2, mostly do so out of principal. We recognize there are risks involved with removing OPR and effectively allowing trade throughs, but we see no other way of addressing the root cause of high RTMD fees – too many marketplaces with too little competition.

We thank you for the opportunity to comment.