

Assessing The FCA Data Study's Response To User Concerns

By **Emma Radcliffe and Greg Dowell** (April 19, 2024)

On Feb. 29 the Financial Conduct Authority published its final report on its market study into the supply of wholesale financial data in the U.K.

The study was launched on March 2, 2023, responding to persistent user concerns regarding the functioning of the markets for wholesale data, and looked at three separate, albeit linked, markets, namely for the provision of:

- Financial benchmarks across several asset classes, including equities, fixed income, commodities, foreign exchange and interest rates;
- Credit ratings data by credit ratings agencies and their affiliates; and
- Market data vendor services, comprising the redistribution of wholesale data such as trade data, index data, credit ratings agency data, reference data, as well as pricing and valuation data.



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In this article we examine the way in which the FCA went about conducting the study, the conclusions reached in the final report, and the FCA's proposed course of action in light of its findings.

Background to the Study

Over the past decade the FCA has conducted numerous market studies, covering a range of wholesale and retail financial markets, from cash savings to investment and corporate banking. Even so, in certain ways the wholesale data market study stands apart from those preceding it.

The study was conducted under the Enterprise Act 2002, to enable the FCA to examine markets falling outside its regulatory remit. The FCA's previous studies were all conducted under Financial Services and Markets Act 2000 and generally took around 18 months or longer.

However, use of its Enterprise Act 2002 powers meant the FCA had to conclude the study and issue its final report within a statutory timetable of 12 months, as well as an interim report after only 6 months, placing it under significant time pressure.

Rather than being entirely self-contained, the wholesale data market study built upon several years of iterative, informal inquiries conducted by the FCA into the wholesale data sector. In particular:

- A March 2020 call for input on the use and value of data and advanced analytics in wholesale financial markets;
- A January 2022 feedback statement, which stated that respondents to the call for input had expressed concerns regarding vendors' pricing and licensing practices, in light of which the FCA would conduct an information-gathering exercise on the

supply of trading data — the trade data review — then launch two separate market studies into the supply of benchmarks and credit ratings agency data; and

- A June 2022 trade data review, which found that competition appeared not to be working well in some areas, with high prices charged for essential data, limited choice and switching, and complex pricing and licensing practices.

The wholesale data market study was exceptionally broad in scope. The decision to conduct a single market study covering three distinct markets ran contrary to the plans announced by the FCA in its feedback statement, and was not elaborated upon by the FCA, save it noting that market data vendors play an important role in the supply of trade data and their inclusion would enable the FCA to look in more depth at the impact they have on wholesale data markets.

Summary of Substantive Findings

Overall, the FCA did not identify concerns as to the ability of financial market participants to access the wholesale data they need in connection with their operations.

It also found that a large majority of users are satisfied with the quality of the benchmark and credit ratings agency data and related services they purchase. However, across all three in-scope markets the FCA identified evidence of, and drivers for, market power.

Notably, these were:

- Concentrated markets, usually with no more than three key providers in each market, and only two vendors of scale in the market data vendor market — other vendors' contribution to aggregate revenue being in the low single digit range.
- High profitability among credit ratings agencies and benchmark vendors, with some of the latter maintaining operating margins of over 60% in the period from 2017 to 2022.
- Essential data being offered by the key providers in each market, with limited or no effective alternatives. This may be because the data is unique, since users, especially of credit ratings agency data, have to multisource. Or it may be — often in the case of benchmarks — because it has become an industry standard, and its use is demanded by data users' end-clients, particularly retail and institutional investors. This means data users — even large institutions — have limited buying power when negotiating with such vendors.
- Limited competition from challenger firms, with barriers to entry and expansion in each market. These include strong network effects and brand recognition. Further, recent years have seen consolidation among benchmark and market data vendor providers.

The FCA also concluded that data users — principally investment banks and asset managers — may be paying higher prices for data than they would if competition was working more effectively. Vendors tend to have complex licensing and fee structures, which may make it difficult to predict and compare costs and negotiate fees.

Value-pricing — a form of price discrimination — may be used with a view to maximizing revenue, based on users' ability to pay. Further, clauses requiring the purging of historic data upon termination, or purchase of a perpetual license to continue accessing such data, may deter users from switching vendors.

In light of these and other findings, the FCA reached the view that competition in all three markets may not be working as well as it could be.

Proposals to Address Issues

The FCA concluded that there are reasonable grounds for suspecting that there are features of all three markets in the U.K. that prevent, restrict or distort competition.

Accordingly, the statutory test for referring the markets to the U.K. Competition and Markets Authority for an in-depth market investigation is met. However, the FCA also confirmed that it is not minded to make such a reference.

It considers itself well-placed to address the competition issues it has identified, including as part of a wider program of reform that is currently in progress.

The FCA intends to focus its next steps in these markets on two broad areas:

- Looking at where the issues identified in the market study could be addressed through amendments to the applicable regulatory framework.
- Tackling firm-specific issues using other tools, including its powers under the Competition Act 1998.

Review of the Regulatory Framework

As part of the ongoing government Smarter Regulatory Framework Review, retained European Union financial services legislation will be reviewed by HM Treasury with a view to amending or replacing it where desirable from a policy perspective.[1]

The FCA intends to work with HM Treasury to ensure that the implications of the study's findings can be considered during that process. In particular:

- When the U.K. Credit Ratings Agency Regulation is reviewed, the FCA will explore potential ways to improve effective competition and help ensure data is provided on transparent, fair and reasonable terms, including through enhancing free sources of data so that they act as a viable alternative to paid-for data.
- When the U.K. Benchmarks Regulation is reviewed, the FCA will explore barriers to switching and how to ensure benchmarks are provided on transparent, fair and reasonable terms.

With respect to market data vendors, whose data distribution activities are not presently regulated, the FCA references the work it is doing to facilitate the launch of consolidated tapes or feeds for both bonds and equities. This is expected to occur in 2025 and 2026, or later, respectively.

The FCA hopes this will increase competitive pressure on the generators of trade data, and feed through into an improvement of the terms under which users receive such data via market data vendors.

Depending on the outcome of that work, the FCA also raises the possibility of strengthening the requirement for venue data to be made available on a "reasonable commercial basis" under the Markets in Financial Instruments Directive 2014, known as

MiFID II, or the Markets in Financial Instruments Regulation 2014, known as MiFIR.[2]

This could be done through amendments to the rules in the FCA handbook, or by publishing guidance for the relevant firms.

Tackling Firm-Specific Issues

The report highlights in various places the FCA's power to investigate allegations of anticompetitive conduct under the Competition Act 1998, where appropriate.

However, there is no indication in the report of the FCA having opened a Competition Act 1998 investigation in response to any particular issues or information uncovered through the study. The FCA does however have three open Competition Act 1998 investigations against as-yet unnamed firms.

Commentary

As noted, this market study was exceptionally broad and — for an FCA study — conducted under unprecedented time constraints. That being so, it was an ambitious undertaking, and in producing this report the FCA has demonstrated its ability to collect, analyze and distill an enormous volume of information, both qualitative and quantitative, in a limited period of time.

However, the final report is relatively light on what the final outcomes might be for market participants. Contrary to previous market studies in which the FCA has identified competition concerns, the report does not set out any concrete proposals for rule changes or other remedies.

Instead, there is a commitment to explore with the government whether those issues can be addressed as part of an ongoing process of regulatory reform that will take another few years.

Also notable is the FCA's explanation for ruling out a more interventionist approach to tackling the issues highlighted in the report.

In particular, the FCA notes that wholesale data users are generally able to access data of suitable quality that meets their needs, data costs are relatively small as a proportion of total industry costs, and there is little evidence of rising prices being passed on to end-investors, such as pension and investment account holders.

In these circumstances, the FCA was reluctant to address market power or pricing directly, citing a potential for adverse "unintended consequences", such as a reduction in innovation or quality.

This cautious approach is perhaps unsurprising, given the FCA's statutory objective of promoting effective competition in the interests of consumers.

In conclusion, despite the FCA having been gathering and assessing evidence for a number of years, regulatory scrutiny of the wholesale data markets appears set to continue. Data vendors and users — and their regulatory and competition advisers — should follow the ongoing regulatory reform process closely.

Any proposals that emerge from that process will be consulted upon in due course, giving relevant stakeholders another opportunity to air their views. Looking beyond the markets for wholesale data, it remains to be seen how quick the FCA will be to conduct another market study under its Enterprise Act 2002 powers, given the greater flexibility it enjoys under the FSMA 2000 process.

Whichever powers it uses, however, respondents would be well-advised to focus their arguments on the evidence of consumer harm, or lack thereof, when seeking to influence the outcome of future FCA market studies.

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[1] <https://www.gov.uk/government/collections/a-smarter-regulatory-framework-for-financial-services>.

[2] Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU; Regulation (EU) No 600/2014 on markets in financial instruments.