



Methodology to monitor changes over time in prices, volumes and costs of trading and post-trading activities

Prepared for CESAME

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Overview

- scope of methodology
- main building blocks
- data requirements
- industry consultation process
- next steps

Objectives

- to design a methodology enabling the monitoring of changes in the prices, costs and volumes of trading and post-trading activities
- trading and post-trading
- role of code of conduct
 - unbundling will facilitate measuring prices of individual services
- lot 1: methodology
- lot 2: application

Scope of methodology

- trading, clearing, settlement and custody
- monitoring prices and volume over time
 - no comparison across financial centres
- equities and bonds
 - not derivatives
- 18 financial centres
- different channels
 - in particular, to capture domestic and cross-border transactions

Market characteristics (I)

- value chain trading and post-trading activities are complex
 - ⇒ methodology follows existing terminology (eg, draft Commission working paper, etc)
- different investors use trading and post-trading services in different ways
 - ⇒ design of user profiles
- trading and post-trading services may be bundled
 - ⇒ different approaches to measuring prices

Market characteristics (II)

- trading and post-trading activities are undertaken by a number of agents in the value chain
 - ⇒ measurement of prices at each level in the value chain
 - ⇒ also allows for measuring costs of using different channels
- competitive markets—innovation, new price structures, etc
 - ⇒ allow for flexibility in methodology

Two main outputs

1. measurement of the aggregate costs, prices and volumes of trading and post-trading activities
 - from the investor's perspective

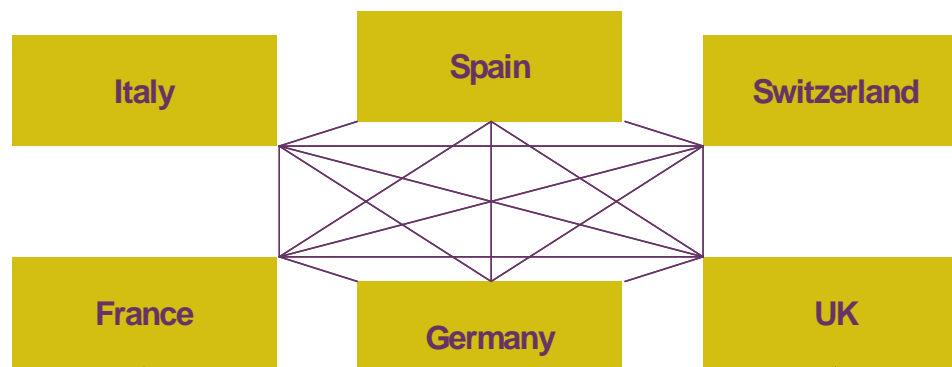
2. measurement of the key drivers of changes in costs, prices and volumes
 - costs incurred by typical agents at each level in the value chain
 - relevant components of trading and post-trading activities

Main building blocks

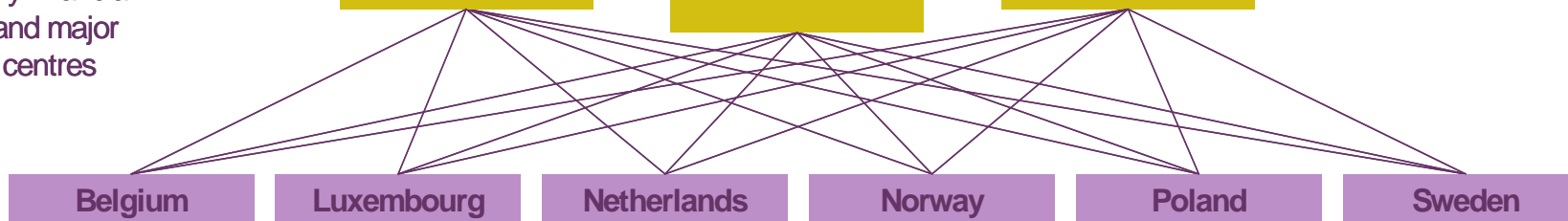
- selection of financial centres
 - understanding of value chain—identification of
 - agents
 - relevant activities
 - channels (for domestic and cross-border transactions)
 - user profiles
 - practical approaches to measuring user profiles and prices
- ⇒ data requirements

Financial centres

1 Bilateral cross-border transactions between major financial centres



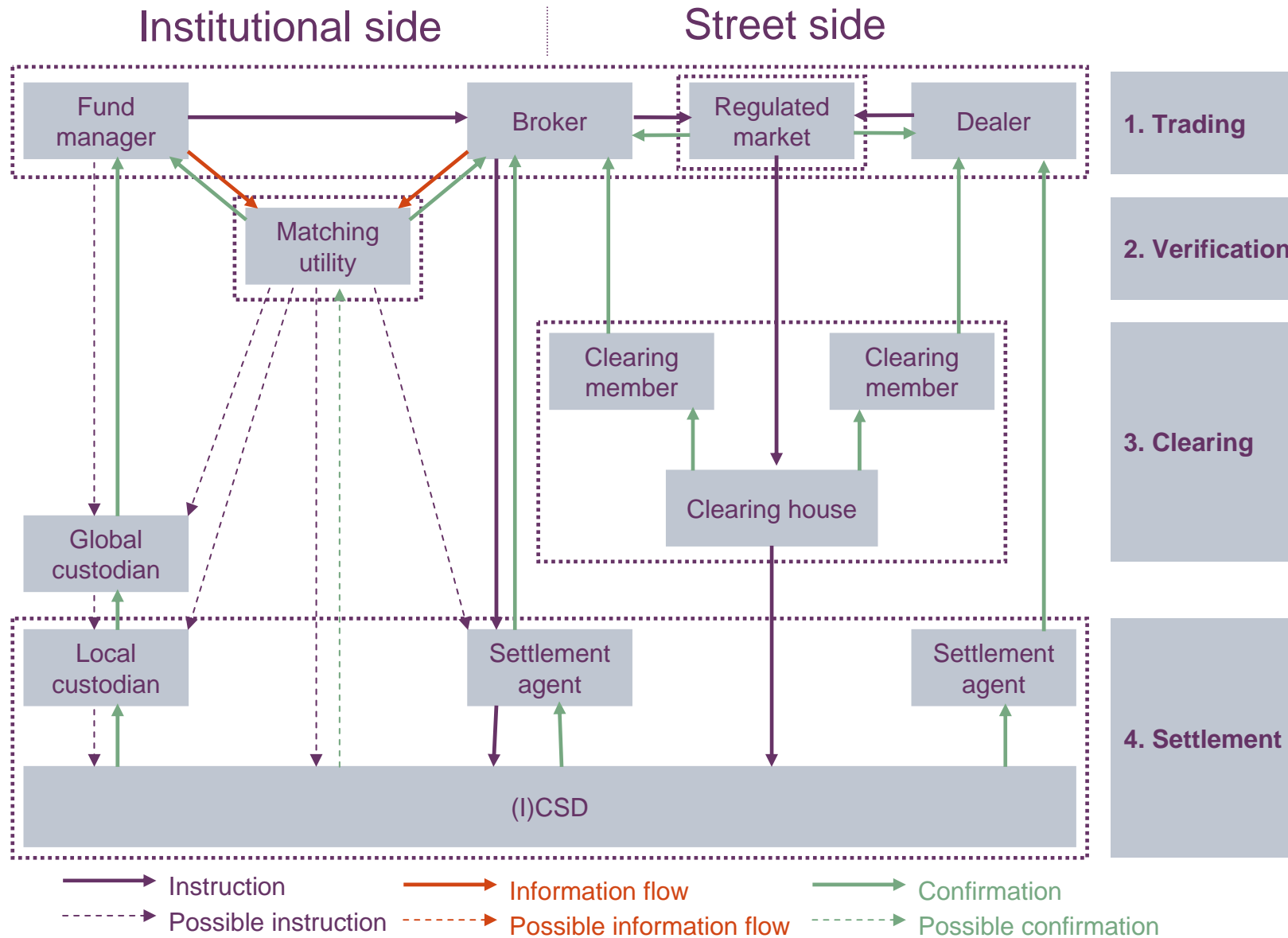
2 Bilateral cross-border transactions between secondary financial centres and major financial centres



3 Domestic transactions within the major, secondary and other financial centres



Stylised description of value chain



User profiles

- typical profiles at each level in the value chain in different financial centres
- user profiles based on data from buyers' and suppliers' perspective

Fund manager/ fund using brokers

Mix of transaction methods
Geographic markets
Annual volume of trading
Amount of research and other services
Other relevant factors

Custodian using CSDs

Annual number of transactions
Average size of transaction
Domicile of securities
Average annual position
Number of securities

Main indicators

Institution and profiles	Price	Relevant transactions	
		Activity	Institution
Investor (small, large, hedge fund)	Negotiated	Settlement, custody	Custodians
Fund management firm (small, large)	Negotiated	Trade execution	Brokerage firms
Fund management firm (small, large)	Negotiated	Settlement, custody	Custodians
Fund management firm (small, large)	List prices	Trade execution	Exchanges
Brokerage firm (retail, small, large)	Internal cost/ negotiated	Trade execution	Brokerage firms
Brokerage firm (retail, small, large)	List prices/ negotiated	Trade execution	Exchanges/ trading platforms
Brokerage firm (retail, small, large)	List prices	Clearing	Clearing houses/ CCPs
Brokerage firm (retail, small, large)	Negotiated	Settlement, custody	Custodians
Brokerage firm (retail, small, large)	List prices	Settlement, custody	CSDs
Custodian	Negotiated	Settlement, custody	Custodians
Custodian	List prices	Settlement, custody	CSDs
Clearing houses/CCPs	List prices/ negotiated	Clearing	CSDs

Approaches to measuring prices for individual services

- new regulatory and industry initiatives
 - Code of Conduct: standard prices for infrastructure services
 - new regime for soft commission and bundled brokerage arrangements in UK
- services that are typically sourced from external suppliers
 - eg, clearing, settlement, etc
 - clean market prices available
- revenue allocation—request providers to notionally unbundle prices of bundled services

Additional indicators

- number of transactions per order
- mix of transaction methods
 - eg, direct market access, agency programme trading, algorithmic trading, etc
- degree of netting by CCPs
- number of failures
 - at different levels in value chain
 - use of fail management services
- innovation
 - improvements to existing services
 - introduction of new services

Output of application of methodology

- changes in prices/costs to investors and services

Example of results

- **reduction** in costs incurred by large investors in Germany
 - analysis of profile: costs of cross-border trading in Polish equities ↓
 - costs of using institutional brokerage firms ↓
 - costs of using CCP services ↓
- **increase** in costs incurred by small investor in France
 - analysis of profile: costs of cross-border trading in UK equities ↑
 - costs of using brokerage firms —

Illustrative examples

- **price** effect
 - for example, removal of certain (Giovannini) barriers
 - increase in efficiency, passed on in the form of lower prices
 - introduction of additional volume discounts
- **volume** effect (changes in user profiles)
 - change in the extent to which services are outsourced
 - increase in quality of service
 - change in type of equities/bonds traded and/or held
 - increase in use of cheaper channels or transaction methods

Data requirements

- investors
 - prices and volumes of services purchased from custodians
- fund management firms
 - prices and volumes of services purchased from brokerage firms and custodians
- brokerage firms, custodians, CCP
 - prices and volumes of services sold and purchased
- exchanges, CSDs
 - prices and volumes of services sold

Consultation process with industry

- presentations to various forums and associations
- meetings with different organisations in value chain
- questionnaires to infrastructure providers and intermediaries
 - to obtain better understanding of services purchased and sold, pricing structure, availability of data and user profiles
- Oxera industry workshop on March 12th
- further consultation in Lot 2

Timetable

- July: publication of methodology by Commission
- July–early September: opportunity to provide further comments
- September: start of Lot 2, data collection
- Lot 2
 - interviews with intermediaries
 - design of questionnaires
 - piloting questionnaire
 - sending out final questionnaires



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