

Forthcoming study on the development of a methodology to monitor the evolution of prices, costs and volumes

Earlier this autumn, the Commission granted a tender to carry out a study on the development of a methodology to monitor the evolution of prices, costs and volumes to Oxera, the Oxford-based economic research consultancy. This note outlines the objectives, likely method and expected output of that study. It is based on the tentative approach outlined by Oxera in its tender submission.

The objectives of the study

The pricing of post-trading securities services is complex. Several studies have attempted to shed some light.¹ Most have concluded that cross-border prices and costs are considerably higher than the corresponding costs and prices for domestic transactions. While useful, none of the results have been universally accepted as providing an accurate description of the prices or costs incurred by investors in acquiring post-trade services in Europe. The objective of this study is therefore to develop a solid methodology that enables the Commission to more precisely follow the future evolution of prices, costs and volumes of post-trading activities and changes of the services offered within Europe. The European Commission believes such a solid methodology will contribute to improving transparency of the current market outcome and the identification of where market efficiencies are being delivered.

Oxera's tentative approach

Oxera's tender submission divides the development of a methodology into two phases of research. The first phase will portray the value chain or different channels through which transactions can be carried out, i.e. answering the question "what to measure". This involves understanding what the market looks like, determining what services to measure (in terms of price and volume), and what investor and transaction typologies to develop in order to monitor the evolution over time. Oxera has highlighted five typologies: (i) type of activity, (ii) type of investor, (iii) type of product, (iv) type of trade, and (v) type of financial centre.

The second research phase will devise a methodology, i.e. answering the question "how to measure". Oxera intends to develop a methodology enabling assessment from two perspectives: (i) indicators capturing total transaction costs and volumes of domestic and cross-border trades, disaggregated across activities using typical investor types and different transaction channels. This will enable changes in transaction costs and services offered, and in investor behaviour over time, to be monitored. This analysis will be carried out from 'the perspective of an investor'; (ii) a framework capturing cost structures (and their evolution) of domestic and cross-border activity of post-trade infrastructures, disaggregated into activities such as clearing and settlement. This will enable identification of average unit cost trends over time. This analysis will be carried out from 'the infrastructure perspective'.

Oxera also has proposed various approaches for dealing with what has in the past been the Achilles heel of all price and cost studies, i.e. access to relevant data. Oxera has put forward various methods depending on the level of access to relevant data that would be made available by the firms during the practical implementation stage of this methodology. Industry

¹ E.g. Giovannini report (2001), CEPS (2001), NERA (2004). The European Commission's Draft Working Document on post-trading services (2006) provides an overview of this existing research.

cooperation is therefore crucial. This was stressed by Commissioner McCreevy, who in his speech to the European Parliament on 11 July asked industry to "contribute constructively to this exercise".

Overall, the study will have a good geographical coverage of financial centres. It will develop a methodology allowing monitoring of bilateral cross-border and domestic transactions, taking into account the different channels of cross-border transaction of securities and post-trading of securities. It will ensure the monitoring and computing over time of defined indicators, and will include the development of practical ways of collecting the relevant information. It will also demonstrate the availability and reliability of data sources and give an indication of the nature of the cost of collecting the required data. The application of the methodology developed will result in the generation of a set of relevant indicators able to monitor changes in the costs and prices of trading and post-trading activities, and the volume of cross-border and domestic transactions, both for equities and bonds. The output will cover both the total relevant activity and information relating to defined user profiles.

The general approach put forward above is based on Oxera's tender submission, and should hence be treated as tentative at this stage. It is currently being refined in view of ongoing and forthcoming discussions with relevant market participants, infrastructure providers and Commission services.

The study's potential contribution to comparability

There has been a degree of confusion around the precise objective of the study and how it fits with the objectives on price transparency of the forthcoming Code of Conduct on Clearing and Settlement. While the price monitoring study is certainly an attempt to shed more light on the murky world of post-trade prices, and while the study will certainly provide useful background elements for price comparability, the two exercises are different.

First, the study will develop a method for monitoring how prices evolve. The fundamental objective is accordingly not comparability. But, there is a degree of overlap, although it is limited. As indicated above, the study certainly involves acquiring an understanding of the value chain and the structure of prices applied by various organisations. While the methodology put forward by the study may enable a better understanding of prices, costs and volumes and make it possible for the Commission to follow their general evolution, it will not necessarily offer a breakdown of prices that is sufficient for users to achieve full comparability.

The study will develop a method for monitoring the evolution of prices paid by certain broad typologies (e.g. depending on the nature of the investor, activity and trade). It will hence have an investor rather than infrastructure perspective. Moreover, it will look at the whole value chain, ranging from trading to clearing, settlement and custody. Finally, it will follow developments across time at a given place, rather than compare places at a given time. In real life negotiations of prices between service providers and users, the latter are likely to want to acquire a more detailed idea of the price they are likely to pay. In short, the typologies likely to be assessed in the study may not be precise enough for such purposes.

Second, delivering a methodology enabling us to follow the evolution of prices is complex enough without adding the even more complex task of delivering comparability. Ultimately, only the infrastructure providers master their business models, service structure and pricing well enough in order to be able to design it in such a way that prices become comparable. Outsiders, notably a research organisation, have limited capacity to overcome these difficulties. So, while the study can provide useful elements, infrastructure providers are best placed and have ultimate responsibility to deliver comparability.

The Code of Conduct

The study is not linked to the Code of Conduct. While the Code contains a commitment for participating organisations to cooperate with the study (point 18), the two exercises are as described above are separate. Moreover, Oxera will naturally have no role whatsoever when it comes to monitoring or enforcing the Code. Such tasks naturally belong to a public authority, not a research organisation.

Conclusion

Oxera's task is to develop a methodology on the basis of easily available data that enables the Commission to monitor the evolution of prices. To be successful, it requires access to relevant data. Depending on the level of access to and availability of relevant data, Oxera has different strategies. For the study to be meaningful, the industry must cooperate and grant the contractor wide-ranging access to relevant data. Nevertheless, however significant the cooperation between industry and the contractor turns out to be, the ultimate responsibility to provide comparability under the terms of the Code lies with industry.

For further queries, please contact Mattias LEVIN (+32/2/295 1811, Mattias.Levin@ec.europa.eu)