Report on the impact of trading fee models on trading behaviour. March 2014.

The International Organization of Securities Commissions has recently published its final report on **trading fee models and their impact on trading behavior**, which provides a comprehensive overview of trading fees and trading fee models around the globe and how they influence trading behavior.
In recent years, securities regulators in many jurisdictions have introduced regulatory frameworks that foster competition among trading venues (stock exchanges and multi trading systems). Advances in technology also have played a critical role in enhancing competition among trading venues by reducing the cost of establishing new trading venues and providing access to new pools of liquidity.

Trading is now fragmented with multiple venues competing both within a jurisdiction and across jurisdictions. These venues compete with trading systems, technology, market models and trading fees and provide investors and intermediaries with greater choice as to where and how they trade.

To gain an understanding of the fee models currently in use and the approaches taken by various regulators in this competitive context, IOSCO distributed a short questionnaire among regulators and trading venues in different jurisdictions. The questionnaire included questions regarding: the types of fee models currently being used, the way in which fees and fee models are being regulated, and the work done to identify the potential or actual impacts of trading fee models. Twenty-two jurisdictions responded to the survey. Approximately seventy trading venues either responded themselves or their views were reflected in the responses provided by regulators.<

The final report presents a summary of the responses and the data obtained (**Key findings**) on the different parts of the survey. In jurisdictions where competition exists, it has resulted in a lowering of fees, changes in fee models and the setting of different fees to incentive market liquidity. Four trading fee models are described but there is not one predominant trading fee model used. The structure of trading fee and trading fee models contains incentives that provide rebates or discounts in order to attract order flow or increase trading volumes, and are often structured to reward participants that provide liquidity to the market.

The data collected did not provide enough clear evidence to IOSCO to draw definitive **conclusions** about the impact or effect of trading fees or trading fee models on trading behaviors and so, IOSCO is not proposing at this stage principles or recommendations. But the process was useful for gaining insight into the structure of fee models in use globally, the extent to which regulators are involved and, in many cases, the standards used by regulators when oversight is performed. The conclusions should be considered by the jurisdictions in which it is necessary to regulate the trading fee in some aspects.

Context of Markets: state of competition and regulatory environment
As it has said above, in jurisdictions where competition exists (Europe, Australia, Japan, USA and Canada), it has resulted in a lowering of fees, changes in fee models (for example, move away from symmetrical pricing), and in a differentiation between or within trading venues of fees that create incentives for liquidity provision, and/or the establishment of fees for different types of securities or trades.

Two jurisdictions have rules preventing the execution of orders that are inferior to other displayed orders, but most have best execution requirements that ask for, at a minimum, searching among some of the venues that could offer best prices. Restrictions imposed by regulators do not generally prohibit the provision of discounts, tailored or negotiated fees/fee models or the differentiation between members and non-members or between types or classes of members (for example, maker makers).

Description of trading fee models and trading fees

The various trading fee models are defined in the survey as follows: 1) maker- taker pricing model: the provider of

liquidity (maker) receives a rebate and the taker of liquidity (taker) pays a fee; 2) inverted maker-taker pricing model: the provider of liquidity (maker) pays a fee and the taker of liquidity (taker) receives the rebate; 3) symmetrical pricing model: where both the active and passive side of a trade pay the same fee; and 4) asymmetrical pricing model: where both the active and the passive side of a trade pay a fee, but the fee paid is not the same.

There is not one predominant trading fee model used. Also, many trading venues use more than one type of fee model. Approximately 80 % of responding trading venues used a symmetrical pricing model, 70% used an asymmetrical pricing model rates, and 20 % used a maker-taker model or an inverted maker-taker model. The maker-taker model and the inverted maker-taker model, that were first introduced in 2006 in north America and in 2010 in Europe, are being applied for equities trading. For derivatives markets, it appears that the most common form of pricing model is a symmetrical pricing model. Regardless of the type of pricing model, trading fees are most commonly applied to trader and not to orders and the more prevalent basis for levying trading fees for cash equities was a value-traded variable fee basis. For derivative markets, the most common basis is a per-contract fixed charge.

The incentives and effects of trading fee models and trading fees: beneficiaries

Various jurisdictions raise concerns about the potential conflicts of interest the incentives may create at the expense of the quality of best execution for trading venues clients. Other possible factors that can also incentivize or affect trading behavior are: structure of the market, the degree of fragmentation, market quality, regulatory requirements, technology and other auxiliary service offerings.

In those jurisdictions where either a maker-taker or asymmetrical pricing models are widely employed, it is generally believed that the result has been an increase in trading volumes, narrowing of spreads and greater liquidity. Regarding price discovery, there is no consensus on whether incentives are potentially harmful to the process of price formation and its impact on price volatility. The type and degree of the impact of incentives on investors is unclear and the benefit would only accrue to the investor if passed down by the participant which is not usually the case according to the results of the survey.

Competition

Multiple trading venues and competition between them has had a clear impact on the level and structure of fees and fee models. In competitive markets, there has been a move away from basic symmetrical pricing models to more multifaceted pricing structures that include fees that provide incentives for the provision of liquidity. You need to balance the benefits that incentives produce and the potential for incentives to distort markets and price discovery. Also, there could be a conflict of interest if the intermediary chooses a particular venue with the aim of reducing costs but this choice is not be consistent with the best interest of the client execution.

Regulation on fees and fee models

ome regulators approve directly fees and fee models of trading venues but few are involved in setting of fee or fee or models. However, regulators generally review the trading fees or models -along with other requirements such as the fair access- in platforms and stock exchanges to see if they are abusive or unduly discriminatory. Most jurisdictions consider it discriminatory if unreasonably restricts access and/or discriminates against a particular class of market participant.

Fee and fee models are, generally, transparent to the public due to regulatory requirements or commercial concerns. Transparency also enables users to assess the costs associated with accessing these services.

If you want to read the full report, please, click on: http://www.iosco.org/library/pubdocs/pdf/IOSCOPD430.pdf