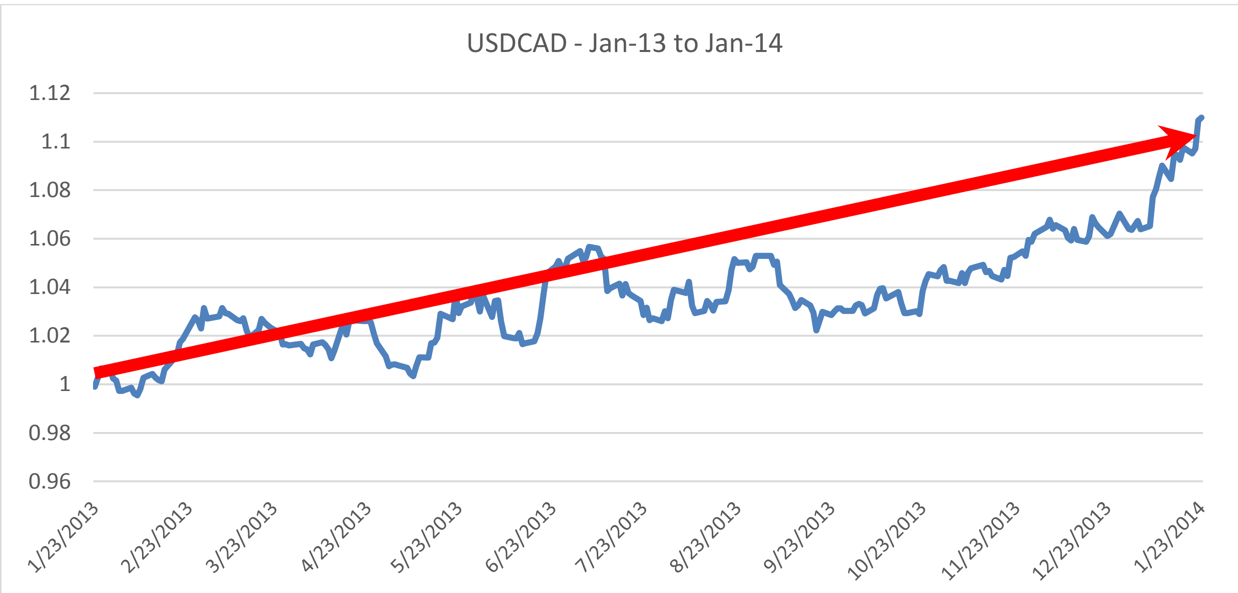
MDC Forecasts 10-13% Increase in Market Data Spend

Without any change to consumption, service mix, or even annual price increases, Canadian-based financial services firms **can expect a +10% price increase in their Market and Reference Data spend** for 2014. To understand why, firms need only look to the fall of the CAD$ relative to the US$ for the change that will impact their General Ledgers.



On average, **80% of Market and Reference Data Source Providers used by Canadian financial services firms invoice in non-CAD$.** The dramatic reversal in USD/CAD of the past 12 months will negatively affect their spend management as their reporting, per government and regulatory requirements, are in CAD$. Even if these firms were nimble enough to miraculously adjust their service mix, or source lower cost alternatives within the next 3 months, contract obligations likely have them weighed down and locked in for 2014. Add to that annual vendor price increases of 3-5%, and Market Data Management teams along with Finance should anticipate some anxious moments explaining why budgeted spend is so far off line.

A lower Loonie is not new to Canadian firms, however the reality of their FX exposure in Market and Reference Data spend will be more evident in 2014 than the last 10 years. While the spike itself is troublesome, the rate and direction of change is something not expected or experienced in a long time. Other than the +25% spike in 2008 (which while double the magnitude of 2013 was short-lived and grossly over-shadowed by the credit crisis), little attention needed to be paid to this variable. Arguably creating a sense of complacency after a near perfect 10 years of annual declines in the USD/CAD rate. This draws into question:

1) **Were cost management programs effective for achieving savings goals since 2008?**
   - Not likely. Most firms do not isolate FX to understand how the 25% increase helped.
2) **Did firms account for a decreasing CAD$ cost-base in their annual budgets?**
   – Many aren't organized in a manner to measure firm-wide FX exposure to Market Data.
3) **Do Canadian financial firms have a strategy to manage their FX exposure (e.g. hedging)?**
   – The problem has been "hidden" for too long to expect it to have received much attention

It's ironic to think that financial services firms, long providers of financial expertise for a fundamental Canadian truth, would not have the where withal to apply the same currency management principles to themselves that they do to their clients. However recent history (2009-2013) and Market Data Invoice Management hold some clues to this contradiction.

CAD$ 2009-2013

It's easy to see how CFO's and Finance Departments had little cause for concern about the FX impact on Market Data *spend* over this period. The first two years saw a >25% increase in CAD$ which provided great support for savings programs (arguably providing all the savings for some). The subsequent years from 2011 to 2012 were more volatile, but relatively stable on a year-over-year basis, creating a false sense of security that FX was *not* a significant contributing factor. Only in early 2013 did the realities of their FX exposure resurface, providing the first real reminder that our US$ dominated vendor relationships will directly affect Operating Margins.

Market Data Company

Managing FX

Listed below are some of the strategies we hear from Canadian-based firms for handling FX. They are by no means formal, or exhaustive, however there is enough anecdotal evidence to support the notion that FX risk has not been a priority.

Strategy	Where it works	Why it isn't effective
1. Inflate all MD spend by X% (where X equals the FX rate)	As a simple proxy, above and below which one can measure change, inflating all market data spend by the FX impact is an acceptable baseline amount.	Annual invoices, and exchange rates for paying those invoices are set on the date paid. Given wildly fluctuating FX rates (e.g. USD/CAD changed 6% from Nov-13 to Jan-14), the amount used is merely guess-work and the variance no better understood.
2. Report only in USD$	Eliminates uncontrolled variable (FX) when measuring spend management performance. Isolating variances to vendor costs and consumption eliminates distortion of fluctuating exchange rates or invoice payment timing.	Budgets, Actual Costs and **P&L's** are the domain of Finance Departments. In fulfilling their reporting responsibility to government and regulators (in CAD$), there is an expectation that any reporting or analysis is consistent with those routinely produced.
3. Do nothing	The effort to control, relative to the value of knowing why Operating Margins are healthy, is equivalent to explaining a joke when the crowd is already laughing	The firm is ignorant to why their market data costs change, they lack the ability to measure how they are managing their third-party relationships, and they are ill-equipped to plan for their business.

Fundamentally, none of these strategies are good management practices as they don't properly measure the risk (FX exposure) and they don't integrate with how Finance departments report. This second point is a structural issue because separating costs into local and billable currency is available to anyone using an Inventory Management System. The challenge is for making the analysis from those systems translate into Finance Reports whose dependence is on Accounts Payable and Invoices as the commonly accepted story-tellers about spend. Absent the granular details, "chest-bumps and high-fives" have prevailed at the quarterly and annual spend reviews over "analyze and explain" because Operating Margins look fine. "Do nothing", as it turns out, was probably the most reasonable strategy to adopt for managing FX exposure to Market Data Vendors given that the added transparency would have had little effect on decision making (people liked the punch-line).

Firms did not take added steps to understand the FX impact because they were either unaware of the size of the risk, or they were all too aware of the effort which would have provided little financial value.

Non-controllable and Controllable spend

The importance Market Data Company places on FX is with isolating, and discounting, it as a non-controllable cost. Left unchecked, it distorts information commonly consumed by the organization. Unique tracking is required for Analysts to distinguish usage and distribution (or controllable variables) to maintain accurate performance measurements. For example, if monthly cost for a service remains flat over a 12-month period where there is a 20% appreciation in the local currency (CAD$), then there could in fact be increased usage, increased price, or a billing error hidden in the "favourable" spend pattern. Conversely good spend management programs could be masked by a dramatic depreciation of the CAD$.

The point is not that FX needs to be controlled, but rather that it needs to be measured and counter-balanced alongside the many factors that impact service distribution, usage, and pricing that make up an effective spend management program. Market Data Teams have the tools and ability to isolate these variables at a very granular level, and to clarify the risks for firms to manage. However until they can resolve to integrate that information in a manner that Finance can represent in Management reports (specifically the P&L and Budget Variance), then the thought of managing FX is a non-starter. Only in understanding the risk (or size) of their FX exposure will firms undertake the investment to establish the required controls. Question being, is a +10% market data spend increase for 2014 enough to accept consider the tradeoff? Start by asking your Market Data team or Finance department to quantify how much of your Market and Reference Data spend is in non-CAD$ - feeling the anxiety yet?

Since starting this paper an article in the Financial Post on January 28, 2014 cited a TD Analyst claiming the FX impact will have a 1-2% ***positive*** *impact on* ***revenues*** *for Canadian-based financial services firms (read Operating Margins may not suffer despite increasing costs)… Ignorance, as it relates to understanding FX impact it seems, might in fact be bliss. If you subscribe to this thinking than we suggest the following: Take a print of the chart on the first page, bring it to your next management meeting, and when someone observes a spike in contract costs compared to last year THROW the print-out onto the table and your hands in the air claiming "it's that Bank of Canada conspiracy to drive down our beloved Loonie!".*