

INVESTORS WILL SUFFER IF THE POWER OF THE BIG 4 INDEX PROVIDERS IS NOT CHALLENGED

- *Big trees, tiny saplings and why the world of indices is in desperate need of innovation*

The world of indexing has the potential to be truly innovative but the current makeup of the market is preventing providers from creating products that deliver true choice for investors. At Moorgate Benchmarks we are determined to change this and believe that progress is impossible without real disruption. It certainly won't be easy but it's necessary.

Anyone with a penchant for horticulture will know that, in order to create a vibrant ecosystem in the truest sense of the word, you must consider many factors carefully. First, you have to choose a plot of land that has ample sun and shade for flora and fauna to thrive. You must ensure sources of nourishment are ample. Finally, and crucially, you should never allow a single species to become too dominant. This would only threaten the existence of other organisms, stifle diversity and upset the careful balance of the environment.

An idyllic garden might not be an obvious metaphor for the world of indices and benchmarks, but there are striking parallels.

We're encouraged by the fact that, over the past three decades, the garden we've been working in has grown extensively. The soil has proved fertile with the value of global assets under management greater than ever, product diversity is rich and in many cases accessibility has improved too. The huge shift from active to passive management is clear, fuelled by lower costs and greater transparency. This has proved a boon for the end investor.

However, if we examine the landscape more closely, there is cause for concern.

The greatest beneficiaries of the market's growth have been a small handful of large index providers - heavy-set oak trees, if we stay with our plant-based theme. In today's market, these incumbents completely dominate. The impact can be seen in the fees they are able to charge. Over the last ten years, the annual total expense ratio (TER) - the annual management fee charged to investors - for ETFs has declined by 32%¹ on average for all asset classes in the EU across a representative random sample. However, anecdotal evidence suggests that fees charged by the major index providers have barely declined - if at all - over the same period. Yet revenues have continued to grow.

Furthermore, creativity is being stifled, so it's becoming increasingly difficult for product providers to source high quality, bespoke and optimised indices swiftly unless they embrace self-indexing or have sufficient scale to influence one of the big index providers. The incumbent oaks have starved other organisms of sunlight, water and air, leaving very limited opportunity for new seedlings to emerge, flourish and bear fruit. Sadly, these practices are going unchallenged due to the sheer magnitude of their market share which is estimated to be as much as 80%. This underscores exactly why evolution is no longer good enough. We need revolution.

In this way, the irrefutable power of major players such as FTSE Russell, S&P, MSCI and Bloomberg is stifling innovation amongst product providers, especially the new, smaller to mid-sized ones.

¹ Source: Ultimus



This in turn is limiting choices for end investors because innovation goes above and beyond index design to encompass processes, operations and technology – all of which contribute to a seamless user experience and help deliver a better investment outcome.

These giants are extracting fees from their clients that exceed the true value of the services they provide, simply because they can. Why should end investors pay more than they should for what is essentially a commoditised product?

As is the case in virtually all pockets of the financial services sector, new players are appearing with the desire to compete with the incumbents. But more often than not, the firepower of these debutants is limited by their scale, cost-sensitivity and - sometimes - expertise. In some cases we've also seen supposed challengers simply adopt the practices of their larger peers. While it may be tempting to follow the path of least resistance, in an industry ripe for disruption, exploring uncharted territory could pay off handsomely.

We envision a future of hyper-personalisation, where bespoke indices can be created swiftly and on demand, allowing investors of all shapes and sizes - from consumers to multi-billion dollar asset managers - to gain access to indices with unconditional transparency and optionality. Our mission is to foster creativity, efficiency and choice. In this way, we will empower individuals to be the architects of their own financial futures.

So where do we go from here?

We're under no illusion that there's a single silver bullet. But we're certain that the index industry can learn from other areas of financial services where the power of innovation has already been leveraged to huge advantage.

In many senses the world of indices is stuck in the past. While name recognition is reassuring and the status quo often comfortable, the industry needs to develop for the sake of investors. Earlier this year, an extensive piece of research published by the Confederation of British Industry (CBI) and technology firm Oracle, showed that overcoming businesses' reluctance to adopt new technology and innovate digitally could add up to £100bn to the UK economy and reduce income inequality notably. We're not surprised by this conclusion and think that it illustrates just how important it is to embrace new opportunities - both in the world of indexing and beyond.

What's more, while it's easy to dismiss this issue as only relevant to a select elite of finance professionals cooped up in their offices in the City of London or on Wall Street, it's important to understand that the world of indexing ripples through all our lives – from the money we save, the mortgages we have and the cash we hope to rely on when we retire. The aging population across western Europe and North America means we're staring down the barrel of a gun: The pensions crisis is real and no government is going to fix it singlehandedly. Yet a more progressive indexing world could create a fairer financial future for all with the potential to deliver better investment outcomes.

As industry veterans and experts, we established Moorgate Benchmarks to address the inertia shackling the industry. We want to enable innovation and deliver true choice. To help create a market in which the rules are not made by a handful of behemoths rooted in an antiquated world.



Just like a garden, financial markets will always have systems and features that can be improved. Lawns must be aerated, flowers dead headed and weeds pulled. Getting rid of the old to nurture the new is no effortless task, particularly in an era of unprecedented geopolitical upheaval. But dirt beneath your nails and blisters on your hands will quickly be forgotten when you catch sight of the blooming roses. Generations to come will thank us for keeping the ecosystem healthy.

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Moorgate Benchmarks

Empowering innovation, delivering true choice

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