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Financial Conduct Authority
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Submitted to: assetmanagementmarketstudy@fca.org.uk

London, February 20nd 2017

Asset Management Market Study Interim Report (MS15/2.2)

Dear Sirs,

IHS Markit is pleased to submit the following comments to the Financial Conduct Authority (FCA) in response to its Asset Management Market Study Interim Report (the Report).

IHS Markit (Nasdaq: INFO) is a world leader in critical information, analytics and solutions for the major industries and markets that drive economies worldwide. The company delivers next-generation information, analytics and solutions to customers in business, finance and government, improving their operational efficiency and providing deep insights that lead to well-informed, confident decisions. IHS Markit has more than 50,000 key business and government customers, including 85 percent of the Fortune Global 500 and the world's leading financial institutions. Headquartered in London, IHS Markit is committed to sustainable, profitable growth.

As a leading independent provider of fixed income and macroeconomic indices, IHS Markit calculates more than 17,000 indices globally. Our indices include the iBoxx bond indices, the iTraxx® and CDX® credit derivative indices.

IHS Markit also works with asset managers through its Markit Digital service to create managed technology services. We create innovative engaging designs that are easily implementable and support investment decisions. Markit Digital is one of the world's largest employers of web designers focused solely on the presentation of financial information and workflows. We are expert in presenting complex information so that users can understand and use it to make informed investment decisions in a timely manner. During a typical week, our services support more than 2.3 billion page views of dynamic content and more than 2.5 million unique users log into the pages we host. Markit Digital's unique position as the provider of technology services to a large number of asset managers and other investment professionals in numerous jurisdictions mean we have broad-based experience of how financial institutions connect and interact with their clients.

General comments

Indices and benchmarks play an important role in enhancing transparency, liquidity and access for financial markets around the globe, they contribute to broadening the base of investable assets and are crucial elements driving economic development. The financial services industry is also going through radical change through the application of robo-advice and artificial intelligence, which could help provide solutions to a number of the problems identified in the Report. We read with interest the FCA's comments about the use (and potential use) of Benchmarks by the asset management industry and need for better information to be provided to investors and thought the FCA might find our comments, based on our own experience, useful.

We provide detailed comments below but would like to make the following general points:

- i) IHS Markit is one of the leading providers of benchmarks to the asset management industry and we dedicate a great deal of our resources to customising our products to the specific needs of our clients. We would strongly support measures that would clarify and strengthen the appropriate use of benchmarks and agree it could be beneficial for investors;
- ii) we would urge the FCA to consider the objectives of its asset management study when implementing the Benchmark Regulation to avoid regulatory burden and the chilling of activity and innovation in the sector – something that would be contrary to the FCA's stated objectives;
- iii) passive funds are among the simplest ways that investors can use to gain exposure to markets in an efficient, low cost manner; and
- iv) we agree that relevant and timely communications and online access can help investors understand the performance of their portfolios and improve decision making around investments. IHS Markit has developed services that can analyse large amounts of data around portfolios and present it online in a tailored manner appropriate for the investor and their objectives.

Detailed comments

In their report, the FCA invite comments on, inter alia, communication with clients and the appropriate use benchmarks, particularly in the context of empowering investors to be able to better understand their investments and make informed choices. Our comments on both topics are set out below

Benchmarks

When an asset manager uses a benchmark to measure and inform investors of its performance it is vitally important that the benchmark is as closely correlated as possible to the intended measurement. The report rightly suggests that passive funds tracking benchmarks and indices will often apparently underperform.¹ This is because the benchmarks will not generally reflect the costs of trading. This apparent underperformance might provide a disincentive for investors to invest in passive funds even though they offer the best value to some investors. Similarly, the apparent outperformance of an active fund against a particular benchmark might provide a signal of a fund's success. However it does not adequately inform the investor of the return versus the risk taken, something important for investors to understand.

IHS Markit believes that passive funds represent the simplest way for investors to gain market exposure in a simple, efficient and low cost manner. Passive funds can provide such market exposure in a broad or focussed manner by providing replication of the investment being targeted. The indices that underpin these funds should seek to follow the desired market as closely as possible and so provide market returns to investors as close to the target investment as possible. As the indices do not attempt to outperform their market, passive funds do not require the additional costs (such as research and trading costs) of managers who seek outperformance, which are ultimately passed on to investors. Furthermore, assuming passive funds effectively track their target markets, the risks of persistent underperformance are minimised and investors can more easily understand whether they are getting value for money from their investments.

However, IHS Markit also believes that some investors will continue to need active funds to invest in and agrees the FCA should set out its expectations around the use of benchmarks to illustrate fund performance.² These expectations should focus on ensuring the benchmarks used are the most appropriate measure possible against the criteria of a fund's investment strategy, objectives and target market. IHS Markit, and its competitors, design indices that can provide close approximations of the market reality asset managers are seeking to replicate or measure themselves against. For example our iBoxx indices, which use publically disclosed rules-based methodologies, can provide an effective measure of fund performance. Our experience in the creation of indices allows us to offer clients access to broad index solutions and a fully customisable service in line with their investors' needs.

The Report also considers barriers to entry and innovation in the sector and how investors do not seem to benefit from increased returns from economies of scale, suggesting such benefits are captured by fund managers.³ The Report identifies these as potentially working against the interests of investors.⁴ The way asset managers license benchmarks can contribute to incentives to increase the assets under management (AUM) of the fund or form a barrier to entry to smaller funds. Many asset managers license benchmarks on a 'per use' basis and this leads to fund managers

¹ 4.14-4.17 of the Report

² For example, as suggested under 10.24 of the Review.

³ For example, 1.20, 5.50, 6.75, 6.89 of the Review

⁴ 6.4, 8.69 of the Review

retaining the cost benefits of an increase in the size of their fund and smaller funds paying disproportionately more for their use. This provides incentives for fund managers to grow AUM and means higher costs for smaller funds seeking to enter the market and attract new investors. Although there will always be some element of fixed or minimal costs, encouraging the asset management industry to move to an AUM benchmark licensing model would help address these issues. It would also reflect the ways costs rise for benchmark administrators under the incoming EU Benchmark Regulation as the proportionality foreseen in it and the categorisation of benchmarks as significant or critical will depend on a measure of usage, including AUM.⁵

Finally we would like to comment about the implementation of the EU Benchmark Regulation. IHS Markit strongly supports the aims and objectives of the Regulation and believes it can make a significant contribution to ensuring benchmarks in the EU are robust and reliable. However there remain some uncertainties about the way the final rules will be implemented, particularly in how benchmarks produced before the regulation is fully implemented in 2020 (the so called transitional period) and from jurisdictions outside the EU will be treated. We would urge the FCA to avoid implementing the Benchmark Regulation in a way that creates unnecessary burdens, barriers to innovation, and restrictions in access to global benchmarks. Such outcomes are likely to work against the interests of the investors the FCA is seeking to support in the Review.

Information for investors

As the Report highlights, it can be difficult for investors to receive appropriate information in a timely and understandable manner.⁶ This potentially leads to suboptimal decision making by investors and their advisors. The Report also highlights that making information available online could be beneficial.⁷

IHS Markit has been developing a number of products that could be useful in meeting the FCA's objective of ensuring investors are properly informed. We have developed systems that are able to: source and analyse a wide range of data; extract and process the information that is of most importance to an individual investor and their investment objectives; and present them in a format appropriate to their expertise and objectives. These systems create portfolio reports designed for optimal clarity, analysing raw data using Artificial Intelligence and generating text and graphical outputs that explain quantitative performance evaluations, ratings and recommendations.

Examples of such technology can be found on the Financial Times website, including financial details for a company. Textual explanations and graphical displays are used to help users understand a company's financial results or allow users to select investment funds or exchange traded funds meeting various combinations of criteria including performance, fees, and third party ratings. Additionally, combined with specific user

⁵ For example Article 20(1)(a) which describes a critical benchmark as one which is used for, inter alia, measuring the performance of investment funds having a total value of at least EUR500 billion.

⁶ For example 4.62, 4.92, 4.95 of the Report

⁷ 4.11 of the Report

profile data (which could be, for example, acquired through questionnaires or similar methods), investment options and tools can be tailored to help meet the MiFID II suitability requirements.

We believe that greater use of this type of technology could be extremely beneficial in reaching the objectives identified in the Report. We would be happy to discuss our work in more detail.

We hope that our above comments are helpful. We would be more than happy to elaborate or further discuss any of the points addressed above in more detail. If you have any questions, please do not hesitate to contact us.

Yours sincerely,

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