Changing Hands: Why Banks Have Divested Their Fixed-Income Index Businesses, and What That Means for Investors

Steven D. Berkley
Global Head of Indices
Bloomberg LP

When Bloomberg started acquiring fixed-income indexes in 2014 — the UBS Australia Bond Indices, followed by Barclays Risk Analytics and Index Solutions (BRAIS) in 2016 — the company seemed to have touched off a trend. In 2017, the bond index families of Bank of America Merrill Lynch and Citi were acquired by the Intercontinental Exchange and London Stock Exchange Group, respectively.

This shift of indexes from bank providers to third parties is the culmination of several factors that have built over time, which have driven banks to tighten their focus on core competencies and fostered the rise of independent index providers.

BANKS: WHERE IT ALL BEGAN

There was a time when developing, marketing and supporting financial market indexes — whether for stocks, bonds or subsets of those — made sense for banks. These benchmarks, given away or at low cost, were points of entry into relationships with institutional clients who would then conduct other, more profitable business with those banks.

Index provision was an expensive proposition. As long as the benchmarks generated revenues, such as in commissions for the fixed-income trading desk, it was worth it. But as directed trades gave way to best execution, banks could no longer afford to give indexes away.

In recent years, the growth of passive investing strategies, accompanied by a dramatic rise in the quality of market data and advanced technology available directly to the buy side, has given investors the ability to do much for themselves that they previously sought from banks.

At the same time, regulators have taken note of the increase in index-based investing. Leery of the potential for LIBOR-like manipulation in other benchmarks, the European Union implemented the European Benchmarks Regulation in 2016. In effect as of Jan. 1, 2018, this regulation codifies and builds on IOSCO's recommendations for standards of reliability and integrity among indexes and providers.

For banks already burdened with regulatory compliance requirements and costs, this may have been the final straw. Steve Berkley, global head of Bloomberg's index business, has had a front-row seat to the evolution of the index business. Most of his career was spent as the global head of the index business at Lehman Brothers, where many of the Bloomberg Barclays Indices originated.

Berkley explained why the divestiture of indexes by banks is such good news for investors. Historically, access to index data was a privilege reserved for the banks' best customers.

"At Bloomberg, we're democratizing this whole process," Berkley said. "If you have a Bloomberg Terminal, you just log in to see the constituents, the performance and the risk characteristics of any of our indices, and at no additional cost."

Bloomberg is also introducing tools to help clients customize and create indexes. The increased availability of index data and index development tools could help institutional investors and their money managers quantify performance, particularly as they seek new returns in non-traditional strategies or alternative asset classes.

> "At Bloomberg, we're democratizing this whole process."

THE PILLARS OF INDEPENDENCE

To give investors the insights and tools to customize indexes requires a certain set of skills and expertise, what Berkley called the "five pillars." These include data, pricing, analytics, distribution and research.

A primary need for index providers is data. Unlike equities, bond markets have a lot of volatility in terms of index constituents due to new issuance, maturing securities, corporate actions and many other factors. It's a vibrant, fast-changing universe, which makes it more difficult to track.

Pricing all the securities included in each index is equally important. Again, in the fixed income world, pricing is complicated.

"Everybody knows the price of Apple or General Motors or any of the exchange-traded companies that are in equity benchmark indices," Berkley said. "But in the bond space, it's much more difficult because bonds trade over-the-counter. And if the constituents aren't properly priced, the index is worthless."

Analytics are necessary to pull all that market and pricing information together into a cohesive index that investors can observe and use. According to Berkley, two levels of analysis go into building an index: single-security calculations (including duration, returns and other risk measures); and portfolio-level analytics, which enable users to compare a portfolio vs. a benchmark and to calculate tracking error and performance attribution.

"The fourth pillar is distribution," Berkley said. "Making sure that you can get all these calculations and data wherever you need to in the world very quickly. That means performing the calculations quickly and distributing them properly in a secure environment."

The fifth and final pillar is research, both quantitative and qualitative. Index providers need to make users aware of how market conditions are affecting both the index and its constituent securities, and develop models and capabilities for evolving markets and asset classes.

"Technology is the glue that brings these pillars together. Being able to use your infrastructure to quickly come to market with new products in areas where there are no established protocols is very important," Berkley said.

An example of this capability is how Bloomberg has addressed emerging interest in China's domestic bond market, the third-largest fixed-income market in the world. Last year, Berkley and his team created a series of "China-plus" indexes, which represented what the world could eventually look like if China were included in the major benchmarks. (Recently, Bloomberg confirmed that it plans to include RMB-denominated securities in several major benchmarks as early as next year.)

Berkley pointed out that Bloomberg is using advances in technology to offer clients tools to create their own custom benchmarks on the Bloomberg Terminal within minutes. By speeding up what used to be a multi-week process, investors can apply new uses for index data — such as testing a strategy to beat a benchmark.

Berkley believes the index landscape will continue to evolve quickly.

"I predict a future where bond indices are calculated in real-time, not just at the end of the day," Berkley said. "Benchmark coverage of the global fixed-income markets will become more comprehensive and the use of alternative structures such as standardized total return swaps will grow." ■

www.pionline.com/Bloomberg_Indexes

sponsored by: **Bloomberg**

P&I CONTENT SOLUTIONS GROUP

This sponsored advertorial is published by the P&I Content Solutions Group, a division of Pensions & Investments. The content was not produced by the editors of Pensions & Investments and www.pionline.com and does not represent the views of the publication or its parent company, Crain Communications Inc.