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TRANSCRIPT

Benchmarking the Index Industry

*Featuring: **Rick Redding**, CEO of the Index Industry Association (IIA)*

Adam Bass (00:03):

This is MSCI Perspectives, your source for weekly research insights as investors respond to the COVID-19 pandemic. I'm your host Adam Bass and today is October 29th, 2020. This week we examine the investment landscape during 2020 by looking at the index industry, which index categories grew through the pandemic, and what effect did it have in terms of existing trends. For this, we turn to the CEO of the Index Industry Association, Rick Redding. Rick and team have just released the results of their fourth annual industry survey. So Rick Redding, thank you so much for joining us.

Rick Redding (00:44):

Pleasure to be with you today. Thanks for having me.

Adam Bass (00:47):

So let's start with the basics. What is the Index Industry Association?

Rick Redding (00:52):

The Index Industry Association is a trade organization that was founded in 2012 and it's a nonprofit organization of independent index providers. Our membership is global, about a third of our members are in Asia, about a third in the Americas, and a third in Europe. The IIA is open to any independent indexed provider with a couple of caveats on membership. Independence means that the administrator or the provider cannot trade the underlying component securities in their indexes, nor do they create products directly for investors. Our members have to be pure index providers and they also have to adhere to upholding intellectual property rights.

Adam Bass (01:48):

So as we record this interview, you are coming from a virtual press conference where you were announcing the results of the fourth annual IIA survey. So what does it look to measure, who are you speaking to? Just give us the high level view of what the aims are?

Rick Redding (02:07):

So when we started doing the survey, we did it because no one knew how many indexes there were globally. There was no one that had ever been able to pull the data together. And one of the things that we saw is, one of the driving needs early on was regulators would ask us all the time, "Well, how many indexes are there in the world?" So what we try to do is determine the number of indexes that exist by category, by asset class, and by geography.

Rick Redding (02:42):

So we look at it and say, how many equity indexes are there in Europe, for example. And within that subset, how many large cap, small cap, mid cap, ESG factor, a whole host of factors we look at and then we roll everybody's data up into a composite. And that's particularly important because this data is obviously very sensitive and the members trust us to do it by not providing their information to anyone, including our other members. Giving you a little historical perspective, when we first started, I think the headline was the fact that there's approximately three million indexes administered globally.

Rick Redding (03:26):

And I think that was the headline story when we first started it, because I think everyone was surprised there were that many. As times gone on and we've had four years worth of looking at this, what we find more interesting is looking at trends we see developing in the industry or with our members specifically. And where they are investing money in research and development, and looking at where the members are focusing their efforts, which pretty much is a reflection of where they think the investor demand is.

Adam Bass (04:03):

And what were those trends? Where are they focused?

Rick Redding (04:06):

So this year we've seen a continuation of trends from the last couple of years. Fixed income, for example, has been a big area of growth. In the last two years, the number of indexes in the fixed income space are up roughly 15%, which is quite big for the number of fixed income indexes that are out there. But we're seeing growth across the board in almost every category. In fact, this year in every category we saw increases in fixed income. Probably the big headline from this year's survey was an ESG, both in fixed income and inequities.

Rick Redding (04:51):

ESG index has increased by over 40%, which has blown away any previous year's record for to see that kind of growth in any category whatsoever. And I think it's a reflection of what the mindset of people is right now, thinking about transitioning to more sustainable type investing world that we're going to.

Adam Bass (05:15):

Certainly climate change on everybody's mind, as well as the resilience. This is a theme that has come up again and again, on this program. The resilience of ESG through the crisis. Are there other factors that you found that might be behind this, what can only be called explosive growth?

Rick Redding (05:35):

Yeah. Yeah, I mean, I think you said it well the way you just phrased it is, these asset light type more socially responsible companies have just from a performance standard done well. So I think that's been driving some of it. I think on a broader scale is you see it in several areas. One is you see a broad regulatory push in Europe. One of the two things that the European Union is looking at as priorities is obviously COVID relief, but their are other major initiative this year has been sustainable finance.

Rick Redding (06:11):

So you have the regulators across the globe thinking about this more holistically. You have investors thinking about it that they want their preferences, their social mores reflected in how they invest. And some of that is demographics, some of socioeconomic things that are underlying this market place. As times change more and more portfolios will move that direction.

Rick Redding (06:36):

I also think there's better data that is coming to this space because unlike a market cap index, there's a lot of inputs into any ESG index. And I think if time goes on, that index data gets better and better and more precise. And I think the indexes will become better and better representations of what people's expectations of whether it's governance or social or environmental concerns.

Adam Bass (07:09):

Would some of that also apply in terms of the growth of fixed income indexes?

Rick Redding (07:16):

Within fixed income, as I said, every category has increased this past year, but we did see an inordinate amount of increase in sovereign debt, high yield, and global or total composite type fixed income benchmarks. Which, when you think about it gets to your prior point about what's happened in the pandemic. Obviously, governments have borrowed a lot of money, hitting on the sovereign debt. A lot of high yield as some industries have been badly hurt by the pandemic. And then I think there's just much more of a global emphasis on investing as there is today. We also see that global trend and on the equity side as well.

Adam Bass (08:05):

And how about some of the other somewhat specialized index categories, factor indexes, for example. Where have they fallen throughout 2020?

Rick Redding (08:15):

So what we've seen on the equity side is factor, semantic, ESG, we kind of all lumped together in a broader category. And we see, obviously because of the growth in ESG, a huge uplift in the number of those indexes. If you unpack those numbers a little bit, you don't see the factor indexes necessarily growing at a huge rate. We saw some growth in the somantic side, which was interesting because that had been stagnant last year.

Adam Bass (08:54):

When we talk about the huge numbers of indexes, as well as the growth, it leads to a natural question about the industry, competition within the industry, and how that's driving this change. This innovation as different firms look at the ways that they can serve different types of investors. What did you find from that respect?

Rick Redding (09:19):

We've seen quite a bit of firms that you would think of historically as equity providers, now providing fixed income indexes or expanding that base out and vice versa. Number of firms that you would probably think of as fixed income shops are now providing a lot more equity indexes. So what I think we see is this movement towards global use of indices. And users, the people that actually use them like the investment management and the investment managers looking to say, "We want consistency across geographies. We want consistencies across asset classes."

Adam Bass (10:04):

Any other thoughts about specifically the role that indexes have played throughout 2020?

Rick Redding (10:12):

So if you think back to whether it was Asia in late 19, or it was the US or Europe in March, April of this year. Think about the dislocations in the market that were taking place because of the pandemic. VIX shot up into the 80s, which that's just unheard of for equity markets. Markets were having a difficult time functioning. Investors we're trying to find data that they could rely upon. And I think index has actually provided that measuring stick role we talked about earlier. An anchoring point for people to say, "Okay, what is real? What is true? Give us some help in trying to think about what we need to do with our portfolios during this time."

Rick Redding (11:05):

And it also plays into the point of indexes have gotten a lot more sophisticated than they were 20 years ago. That just the fact that I'm referencing volatility index is the way for people to look to say, "Wait, what's going on in the market? Is it getting less risky? Is it getting more risky?" So I think it really provided a very important anchoring role during that period because people were trying to figure out and trying to come up with, "What's going on? We've not seen something like this before." From an investor's perspective, that had to rely on something. And

I think they look more and more at indexes. And I think more and more people have started to think about the role the indexes play in the capital markets because of the pandemic.

Adam Bass (11:55):

Absolutely. And Rick Redding, thank you for coming on and sharing your perspectives as well as the results of the survey. Really interesting. Thanks again.

Rick Redding (12:03):

Thanks for having me.

Adam Bass (12:06):

That's all for this week. Thanks to Rick and to all of you for joining us. Next week, tune in for more about the state of the index industry and what it reveals about investors' focus. Remember it takes just a moment to subscribe to the podcast, leave a comment or share with a friend. Until next week. I'm your host, Adam Bass, and this is MSCI Perspectives. Stay safe, everyone.

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