



Benchmarks – *not a word but a sentence?*

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Whenever we get together with clients, one of their most pressing issues is effectively managing the ever increasing cost and complexity of index and benchmark data. Unsurprisingly, recent voting by our members has prioritized this topic for investigation by both Research and Benchmarking later in 2012. In this article, we will detail why benchmarks are so critical to investment management, why benchmark data management is difficult and becoming more challenging, and our recommended responses to this increasingly problematic area.

The pervasiveness of benchmark data

Benchmarks play a key role in the relationship between an investor and the investment manager, and they underpin large portions of the investment process. Investors communicate their objectives through their definition of the investment policy, including the benchmark. In turn, investment managers act in accordance with this investment policy. Benchmark data is an input to many parts of the investment process (as can be seen in Figure 1), most notably the reporting of performance as compared to the agreed-upon benchmark.

Consequently, high quality benchmark data is a prerequisite for enabling an investment manager to reliably meet the desires of the investor and to communicate effectively to the investor on that delivery. Problems with benchmark data can cause problems throughout the process.

One challenge, is that often there are multiple benchmark management processes, particularly in larger and more complex firms.

- Often benchmark data is sourced and managed differently for different processes along the value chain.
- Often firms have different benchmark management processes and repositories for different asset classes.
- Often different solutions are in place in different regions.

This duplication can waste time, effort and cost and can lead to unintended differences in the benchmark data used in different processes. This wouldn't matter if benchmark data was simple to manage, but it's not.

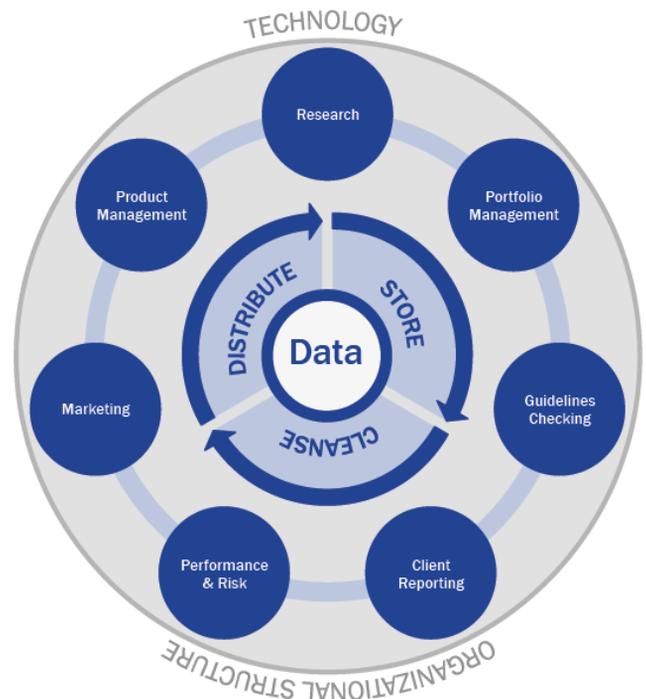
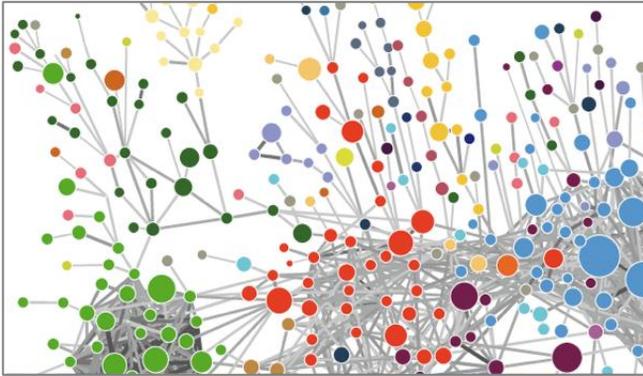


Figure 1: The pervasive use of benchmarks throughout the investment process



Proliferation and increasing complexity

There are hundreds of thousands of indices and the number continues to grow rapidly. For example, MSCI extended the number of equity indices calculated daily from 100,000 to 150,000 in the four year period from December 2007 to December 2011 (a 50% increase). As Michael Petronella (President of Dow Jones Indexes) was so vividly quoted in the 'Journal of Indexes', not only are there hundreds of thousands of indices on the market, "there are hundreds of thousands yet to be created".

Not only are indices and benchmarks growing in volume, but they're also growing in complexity. For example, MSCI recently launched a number of new types of strategy indices (value weighted, risk weighted, equal weighted, and minimum volatility) aimed at better reflecting the role of equity risk premia as drivers of long-term portfolio performance.

The licensing costs of benchmark data have risen at the same time as licenses have become more restrictive. In a recent Cutter client webinar, more than 70% of the 200 attendees reported that cost was an issue, and 64% reported that contract and license management was an issue.

Providers of benchmark data find themselves in a strong position because investment managers find it difficult to replace them. Many firms worry that, as a result, license fees will continue to become more expensive and restrictive.

Benchmark data is *characteristically different*

Very visible rising external costs have obscured the increasing internal difficulties associated with managing benchmark data. Benchmark data is characteristically different from most other data types and presents some unique challenges.

The use of a particular source is often mandated as part of the investment policy. In addition, there are many different index providers, more than for other sources of data.

Effective and accurate processing of all benchmarks can be technically difficult. Large volumes of index data need to be distributed quickly on a daily basis to a number of different processes and systems around the firm.

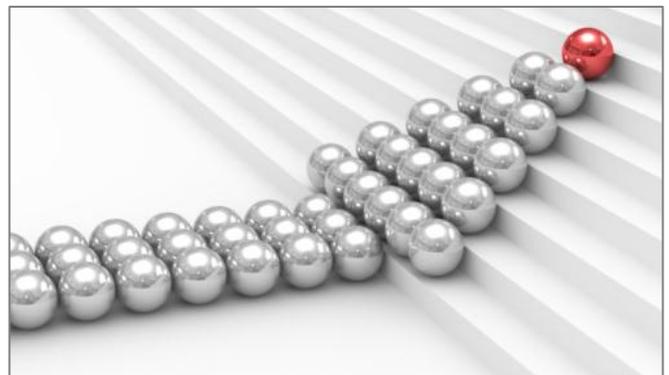
Ensuring good quality data is also difficult. It is much more difficult to perform validation checks against more than one vendor feed. Firms typically take much longer to resolve index/benchmark data discrepancies. Overall, the industry lacks clarity on the impact of poor quality benchmark data, as well as on the real size of the problem and the effort and cost spent preventing poor benchmark data.

Recommendations

Invest in governance for your index and benchmark data

Firms need effective organizational and process capabilities relating to index and benchmark data, especially for the following:

- Establish clear roles and responsibilities, including ownership and stewardship for index and benchmark data.
- Establish clear policies for managing index and benchmark data, including education and communication.
- These policies include the onboarding of new indices and benchmarks, starting with managing client requests for new indices.
- Implement the appropriate data quality processes.
- Establish appropriate metrics and provide regular dashboard-driven MIS.
- Recognize that managing relationships with the index providers will be critical to success.
- Develop strategies and tools to monitor index data usage.



Invest in your operating platform

There are a number of key processes that need to be supported technically, and each presents specific challenges. Wherever possible, the technical architecture should leverage components of the firm's broader data management architecture, for example:

- centralized master and reference data
- message-based distribution of index and benchmark data in standard formats
- business rules for validation of benchmark data and exception-management
- standardized data correction process.

We do not know of any clients that have chosen an investment manager for the excellence of their technical solution supporting index and benchmark data. Many firms consider engaging firms that specialize in index and benchmark processing. Some of the benefits include:

- A single source of data that can supply tailored content to meet the various needs of the different investment management processes.
- A significant reduction in complexity, by reducing (or even eliminating) the point-to-point connections with the large and growing number of index providers.
- A single point of expert contact for questions and concerns.
- Validation and issue management earlier in the benchmark data workflow.

For the full white paper, please [click here](#)

Take a holistic, enterprise view

You must take an enterprise view of the benchmark management process. It is clear that there are specific technical and data quality challenges, and these are going to continue. Rather than separately solving these problems for different business processes or different regions, taking an enterprise view enables firm-wide efficiencies and controls that would not be possible otherwise.

Later this year we will be partnering with our Research and Benchmarking clients to define practical best practice, to simplify the complexity surrounding benchmark data management and to identify the most critical leverage points.

