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Response to FCA Call for Input on Accessing and Using Wholesale Data
From Morningstar

Submitted by email to WholesaleDataCFI@fca.org.uk
7th January 2021

Dear Sirs,

Morningstar welcomes the opportunity to respond to the Call for Input on Accessing and Using Wholesale Data. Morningstar's primary mission is to help investors reach their financial goals and has an extensive line of products for individual investors, professional financial advisers, and institutional clients.

Our response concentrates on Section B of the CFI related to Benchmarks and is informed by Morningstar Indexes, recognised as a Non-EU Administrator of Benchmarks under the European Benchmarks Regulation.

It is our strong view that the index industry needs more competition. We agree that brand sensitivity and switching costs are major barriers to increased competition for benchmarks. Another is lack of transparency around benchmark licensing fees. Because index licensing fees are not disclosed, it is currently impossible to ascertain their true impact on investors. Therefore, we applaud your efforts to solicit more information from the investment industry on benchmark costs and their impact.

In the case of new exchange-traded funds, we have noticed far more willingness to track non-traditional indices. Clearly, asset managers feel more freedom when it comes to new, rather than existing investment products. Also, price sensitivity with ETFs is extreme. Reducing index licensing fees can allow a provider to offer competitive product.

We also note your reference to self-indexing, which we see as an attempt on the part of asset managers to circumvent the dominant index providers. There are certainly potential conflicts of interest that must be addressed with regards to self-indexing. For many asset managers, self-indexing is simply not an option due to operational challenges.

We were surprised by the reference to 'lack of suitable alternatives' as a barrier to benchmark competition. It is our strong view that market exposure indices ('beta benchmarks') representing the same asset class are typically interchangeable. Long-term correlations between, for example, the FTSE All-Share and the Morningstar U.K. Market Index, are extremely tight. We see market beta as a commodity and believe it should be priced as such.

We would like to bring to your attention the attached paper written by Morningstar Indexes in 2019 making the case for increased competition in indexing. A summary can be found here. For an asset management industry facing unprecedented cost pressure, we believe lowering index licensing fees represents an opportunity. As an index industry disruptor, we share your goal of drawing more attention to this issue with the goal of improving the investor experience.

We would be happy to discuss any aspects of the response with you further or provide any additional supporting information that may be helpful.

Yours sincerely,

Andy Pettit
Director, Policy Research (EMEA)

Robert Edwards
Senior Investment Product Manager
Index Products

Morningstar response to FCA Call for Input
Accessing and Using Wholesale Data

<u>Questions for benchmark administrators</u>

Q3.21: Please explain the benchmarks you offer and how you ensure that they meet the needs of your clients.

Morningstar offers benchmarks in different asset classes, including Fixed Income, Equity, and Alternatives. Morningstar has a broad client base, and we are continually receiving feedback from clients in terms of their benchmark needs. We also closely follow the market for new Index trends.

Q3.22: How have your prices and charging structures, volume and value of sales of services and innovation in your offerings evolved over the last 5 years? Please explain reasons for changes in prices and other relevant dimensions.

Like other Index providers, Morningstar has moved away from selling individual benchmarks and have asked our clients to buy a package or family of Indexes, which typically includes dozens of individual benchmarks. The main reason is that it is much more scalable from a technology perspective to deliver a large number of benchmarks, rather than to deliver one benchmark at a time. Morningstar has also moved to this structure, as it is widely accepted as the industry standard. Unlike other Index providers, we charge what most of our clients see as a reasonable fee for Index data, especially for "beta" Indexes. As a small, growing Index provider, Morningstar has seen our sales and service organization grow alongside the rest of our Index business. Increased demand from clients has created the demand for more automation in our client services procedures, increased client service headcount, as well as hiring employees to cover more parts of the globe.

Q3.23: For your main benchmarks/indices, who are your key competitors, and to what extent are their products reasonably good substitutes for yours? How have competitive pressures affecting your business evolved over the last 5 years, including entry/exit of competitors?

Morningstar's key competitors include: S&P Dow Jones, MSCI, FTSE Rusell, Solactive, ICE, STOXX, and Bloomberg Barclays. Their products are reasonably similar and good substitutes to our offering in the "beta" Index space, as explored and illustrated in our attached paper 'Asset Management in an Era of Cost Pressure'. Morningstar offers Indexes that feature unique IP, which are more commonly offered to clients to create investable products. Competitive pressure has increased alongside industry consolidation. Increased consolidation amongst the larger Index providers has made it more difficult for small providers such as Morningstar to compete. The largest Index providers now have much more influence on the industry and have established strong technical standards for their products.

Q3.24: What are the main barriers to attracting users away from your competitors? Please provide specific examples in your response.

The Index industry's largest barriers include brand/name familiarity that the largest Index providers bring, data limitations/availability, and technology scale. Morningstar and other smaller Index providers have brought almost identical offerings of Indexes to the table in the past, yet had their offering rejected by clients (particularly portfolio managers) who are comfortable using Indexes that have been around for a long time and that they are already familiar with. For example, a recent midsized Asset Manager stayed with an incumbent provider as their sales staff thoughts their clients might lose interest if they switch benchmarks even thought they would have considerable cost savings. Even if an established provider has a worse Index methodology, being the incumbent provider is such an advantage as there is very high switching costs to clients. Becoming a benchmark provider is also a very expensive and time-consuming proposition. The costs of data, particularly historical data (example: historical free float data for equities), have become more expensive.

Q3.25: Are you aware of input data providers charging different amounts or imposing different contract terms to different benchmark administrators for similar services? Please provide specific examples where possible.

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Q3.26: Are there markets downstream from benchmark administration where you compete with customers of the benchmark(s) you supply?

Morningstar is a large business with many different functions. Morningstar supplies data to many data and service providers that compete with other Morningstar business lines. For example, Morningstar's Index business may wish for our client to access data through another investment research software platform, and that platform would likely compete with Morningstar.

Q3.27: What, if any, barriers to accessing input data put you at a competitive disadvantage in the design and provision of benchmarks? Please provide specific examples where this happens or may happen.

Data availability is one of the most significant challenges to building robust Indexes that feature a long time series of Index performance data. To calculate an Index accurately, you need many pieces of data from many different sources. Data required include equity and bond pricing from exchanges, free-float, total outstanding shares, and corporate actions.