

TRANSPARENCY IN BENCHMARK COSTS

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Frances Barney: I am Frances Barney with BNY Mellon's Global Risk Solutions Consulting Group and with me is David Spaulding, CEO and Founder of The Spaulding Group.

Many people know that market indexes are frequently used by institutional investors in the asset allocation and performance evaluation process. Some people may not know that these indexes are not free. Index vendors incur costs in creating, maintaining, and distributing indexes, and anybody that uses index-level data, even top level data in reports is subject to licensing requirements and often fees.

BNY Mellon is working with the Spaulding Group and other large custodians to help raise awareness of this issue in the industry.

David, can you help explain why index costs are an industry issue.

David Spaulding: The costs to use and redistribute index data has risen considerably over the past several years, and the industry has responded to that. For example, we have seen some new entrants into the market offering lower cost solutions. Some mutual fund companies have made a decision to change the indexes they use in order to save cost, and some of the largest custodians, who would have previously embedded a cost for index data in their performance services, have adopted the custodian guidelines for transparency in benchmark costs, and are committed to break those costs out in order to provide greater visibility into what they are.

Frances: Can you share how the custodian guidelines were initiated?

David: We became aware a few years ago of the increased costs in benchmark data, and began working with custodians to learn more, and one thing we discovered was that not everybody is aware of these costs, and so we wanted to provide a way to increase transparency and visibility and to educate everyone in the industry.

I am curious, how are the custodians experiencing these increased costs?



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Frances: Well, in addition to the direct costs that you mentioned for redistribution and licensing, custodians also incur indirect expenses to negotiate and contract with vendors, maintain permissions for different levels of index use, and that is based on how each index vendor defines permitted levels of use. Reporting back on client use of market data to indexes and the way that the index vendors change and maintain their own definitions of permitted use, means that custodians are required to continuously make changes to our databases and reporting systems to align with the continuing changes in the index vendor definitions.

David: How would you respond to the suggestion that that is just the cost of doing business?

Frances: For many years, that was exactly how it was treated and that worked fine for everybody. What has happened in the past few years is that the cost of some of the indexes has risen dramatically and it is just not practical to increase overall fees at the same level as the cost of some of the indexes. And the price difference between some of the indexes is dramatically different than some of the other indexes, and it is this price difference that has been invisible to a lot of institutional investors, so there was no way for anybody to communicate any levels of price sensitivity about one index relative to another. In your experience, can you describe who is responsible for selecting a benchmark?

David: The question is more complex than one might expect. One thing we do know for sure, it is not the custodian, although the custodian is responsible for having loads of indexes available to meet the needs of their clients.

Frances: How are the custodian guidelines likely to benefit the industry?

David: The cost of selecting indexes should be taken into consideration when picking them, but in order for that to work, asset owners and consultants need to be aware that they do have choices when it comes to selecting indexes. That is one of the problems today, the lack of transparency. We're working on an article that would be published in *The Journal of Performance Measurement* that will include both quantitative and qualitative analysis looking at a number of indexes for a global equity market as well as the US domestic equity market, in order to compare it to see what the differences are and how the indexes correlate with one another. It is our hope that this will provide, again, asset owners and consultants greater awareness of these differences and perhaps options that they previously weren't aware of that may result in cost savings for them.

Frances: Thank you, David, and thank you. BNY Mellon is committed to working together with the Spaulding Group and our peers in the industry to raise awareness of this issue, and we look forward to sharing our insights with you in the upcoming article in *The Journal of Performance Measurement*.

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