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The AMF publishes a study of the opportunities and risks of the financial index market

The study presents an overview of the market in financial indices, which have a profound influence on the functioning of markets. It analyses the functioning of an industry that continues to grow with close to 3 million indices in the world.

The index industry is experiencing increasing demand and is highly concentrated. Three global players hold a market share of 71% between them and have high innovation capacity. In this study, the Autorité des Marchés Financiers (AMF) assesses two main types of risk: risks concerning the functioning of markets and potentially for financial stability, and risks relating to the lack of competition and its impacts on the protection of investors.

Regarding the risks impacting the functioning of markets, the study shows that the development of funds benchmarked to listed funds and index futures contracts is transforming the ecosystem and structure of the markets, beginning by the equities and listed derivatives markets. Price formation and market liquidity processes are being changed profoundly. More particularly, the study highlights the growing effect of rebalancing (changing the composition of the indices), operational risks such as cybercrime, and the risks of shocks being amplified on futures markets.

The study emphasises in particular the following issues regarding lack of transparency.

- As a result of the lack of competition, the offer is often bundled with data supply services which limits the ability to make fee comparisons.
- The boundary between index and asset management are diminishing as the indices in question incorporate more and more asset management rules and discretion margins. This also increases risks regarding conflicts of interest.
- In an environment of accelerated innovation, it is becoming difficult for investors to assess what the indices represent and to understand their methodologies. This is particularly true of strategy, smart beta, ESG and bond indices, which may cumulate several asset management strategies.

The study makes a number of recommendations to facilitate the identification of indices and comparisons between them, as well as making them easier to understand. More specifically, it would be useful to have a public record of marketed indices. The AMF also stresses the impacts of changes in methodology and index rebalancing on markets. In the context of the health crisis, certain index producers postponed the recomposition of their indices to avoid disrupting the markets further. This supports the hypothesis of the influence of these recompositions on the markets whereas a point of vigilance in the future regarding for example index investment in corporate bonds in the event of ratings downgrades.

About the AMF

The AMF is an independent public authority responsible for ensuring that savings invested in financial products are protected and that investors are provided with adequate information. The AMF also supervises the orderly operations of markets. Visit our website <https://www.amf-france.org> URL = [https://www.amf-france.org/]

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