IDC Independent Directors Council
Promoting Excellence in Fund Governance

August 16, 2022

Ms. Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: *Request for Comment on Certain Information Providers Acting as Investment Advisers; File No. S7-18-22*

Dear Ms. Countryman,

The Independent Directors Council[1] appreciates the opportunity to respond to the Commission's request for comment regarding whether, under certain circumstances, the activities of index providers, model portfolio providers, and pricing services (Information Providers) warrant investment adviser status. We are particularly focused on the implications for fund boards of treating Information Providers as investment advisers under the Investment Company Act of 1940 (Investment Company Act).

The appropriate role of independent fund directors—whose responsibility is to protect the interests of shareholders—is one of oversight. This concept, as well as the specific level of board scrutiny over any one of a fund's service providers, is well established under the Investment Company Act, its rules, and general fiduciary principles. Director oversight is tailored to the characteristics and circumstances of a particular arrangement, taking into account the potential for conflicts of interest raised by the arrangement and the degree of influence a service provider can exert over a fund. This allows fund boards to effectively oversee a provider in a manner that is commensurate with the provider's role and influence.

Given this framework, we do not believe that Information Providers should be categorically treated as investment advisers under the Investment Company Act. Deeming them as investment advisers would subject them to the same degree of scrutiny that is reserved for the most critical service providers to a fund, which also happen to be in a position to exert the greatest influence on a fund, namely the adviser managing the fund and its distributor. In addition, as detailed below, we urge the Commission to consider unintended consequences that could result from concluding that Information Providers are investment advisers under the Investment Company Act.

I. Board Oversight Role

Fund boards play a critical role in protecting the interests of more than 100 million US fund shareholders. Commission initiatives and rules should support and facilitate board oversight on behalf of those

[1] The Independent Directors Council (IDC) serves the US-registered fund independent director community by advancing the education, communication, and public policy priorities of fund independent directors, and promoting public understanding of their role. IDC's activities are led by a Governing Council of independent directors of Investment Company Institute (ICI) member funds. ICI's members manage total assets of $28.1 trillion in the United States, serving more than 100 million US shareholders, and $9.3 trillion in assets in other jurisdictions. There are approximately 1,600 independent directors of ICI-member funds. The views expressed by IDC in this letter do not purport to reflect the views of all fund independent directors.

shareholders by placing them in the best position to serve shareholders' interests effectively. As fiduciaries, boards dedicate more of their time and attention to the matters most important to shareholders' interests. In some instances, the nature and extent of board oversight is determined by the board itself based on fund-specific considerations, and in other instances, specific board oversight responsibilities arise directly from the Investment Company Act and its rules.

The required level of board scrutiny over any arrangement historically has depended on the potential for conflicts raised by the arrangement. For example, some compliance matters require board oversight but not board approval (*e.g.*, code of ethics violations). Other matters, deemed to involve the potential for greater conflicts (*e.g.*, fund mergers), do require board approval.

Similarly, the level of board oversight of different service providers has varied depending on the level of influence that a service provider can exert on a fund and the degree to which the service provider could be tempted to succumb to conflicts of interest. For example, unaffiliated securities lending agents are overseen by boards and typically provide not only quarterly reports but often annual information as well. The board does not, however, typically engage in a detailed annual contract renewal process with an unaffiliated securities lending agent because the agent is overseen on an arm's length basis by the adviser.

The level of board scrutiny is heightened, both as a fiduciary matter and as required by Section 15(c) of the Investment Company Act, with respect to the two service providers that can most directly affect a fund, whose relationship with a fund involves the greatest potential for conflicts and with whom an arm's length negotiation would likely be difficult: the adviser and the distributor. To protect against the possibility of overreach and to offer a fund the greatest protection possible, boards engage in year-round diligence that culminates in a prolonged and detailed review of their contracts.

This framework, which has worked effectively even as the industry has evolved, allows a board to oversee a fund's service providers in the manner it deems most effective, based on the particular circumstances of the funds it oversees and the role of each service provider.

II. Unintended Consequences of Deeming Information Providers as Investment Advisers

The Commission's request for comment suggests that the changing role and growing size of Information Providers may warrant investment adviser status under the Investment Company Act. While it is true that Information Providers can be important fund service providers, we caution against the categorical treatment of Information Providers as investment advisers under the Investment Company Act.

The Investment Company Act imposes specific responsibilities on independent directors and looks to them to monitor potential conflicts of interest between the fund and its adviser. Deeming Information Providers as investment advisers would, among other things, trigger extensive, highly-prescribed board scrutiny for those entities. We are concerned that such an expansion would adversely affect the oversight role of fund directors as well as the shareholders they represent.

Impingement of Director Business Judgment

Boards have been overseeing important fund service providers for decades. They calibrate their oversight role with diligence, taking into account how critical the service provider is and the types of conflicts of interest that could arise from the fund's relationship with the service provider. This has served investors well, and we do not see a reason to curtail the board's ability to exercise its judgment in determining the appropriate level of oversight in light of the facts and circumstances.

Diluting Board Scrutiny of the Most Critical Service Providers

The degree of scrutiny applied by boards to a fund's investment adviser in response Section 15(c) of the Investment Company Act is considerable. A board's Section 15(c) process is typically year-long, as the board focuses on performance and other matters throughout the year. Even the formal process, typically evidenced by a questionnaire and lengthy responses from the adviser, often lasts six months or more. Many boards spend multiple meetings considering information before approving the contract with the fund adviser. It is impossible to overstate the extent of the consideration that directors devote to the approval of this most critical of service provider.

The level of scrutiny demanded by Section 15(c) should be reserved for service providers that are most influential and, consistent with the intent of the Investment Company Act, pose the greatest potential for conflicts. Categorizing Information Providers, which are typically unaffiliated and closely monitored on an arms' length basis, as investment advisers under the Investment Company Act risks diluting the 15(c) process by needlessly expanding it to entities that are simply not as critical nor potentially conflicted as the fund's adviser.

Upending the New Pricing Vendor Oversight Framework

With regard to pricing services, the Commission recently adopted Rule 2a-5 under the Investment Company Act, which will fully take effect on September 8, 2022. The Rule, which represents the culmination of decades of industry input, lays out a thoughtful and carefully crafted framework for director oversight of pricing services. To designate pricing service providers as investment advisers would upend this framework without giving it a chance to succeed.

Discounting Board Oversight Under Compliance Policies and Procedures

Rule 38a-1 under the Investment Company Act requires a fund to adopt and implement written policies and procedures reasonably designed to prevent violations of the federal securities laws. While the Rule focuses on "principal services providers" (the adviser, distributor, administrator, and transfer agent), fund compliance programs also may include oversight of other service providers, such as those contemplated by the SEC's request for comment. Under this oversight rubric, a board has the important assistance of the fund chief compliance officer. We encourage the Commission to recognize that the rigor reflected in policies and procedures adopted by the board and overseen by the chief compliance officer is considerable and is effective in facilitating the oversight of unaffiliated service providers.

Impinging on Board Flexibility

Fund boards can currently approve changes to Information Providers efficiently and quickly. Section 15(a) of the Investment Company Act, however, requires shareholder approval of any person serving as an investment adviser to a fund. As a result, if Information Providers are deemed to be investment advisers, then each time a new Information Provider is engaged, shareholder approval would be required. This would delay board-approved changes of Information Providers for months, and in some cases would prevent these changes from happening altogether, given the challenges that funds often face in reaching quorum at shareholder meetings. It cannot be in the interest of shareholders to reduce the nimbleness of a board that has decided to make a change in Information Provider for the benefit of fund shareholders.

Increasing Shareholder Costs

As noted above, if Information Providers are deemed to be investment advisers, they would be subject to the 15(c) process. Expanding the universe of 15(c) providers to include Information Providers would increase shareholder expenses associated with legal fees, board fees, and the additional resources that would be required to oversee them under 15(c). Further, Section 15(a) would require shareholder approval of each Information Provider currently retained by a fund as well as shareholder approval of any change to an Information Provider in the future. Forcing boards to engage in costly proxy solicitations and to incur expenses, on behalf of shareholders, to oversee unaffiliated service providers is a poor use of shareholder resources with no commensurate benefit.

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IDC promotes effective board oversight that enables fund directors to focus on those aspects of fund management and operations that are of the highest priority for fund shareholders. This includes strong support for board oversight of service providers and certain information providers, provided it gives each board the flexibility to develop an appropriate oversight framework in alignment with the needs of its funds and shareholders.

Recognizing that Information Providers can provide important services to a fund, but also cognizant that in the vast majority of cases they are not affiliates of the adviser or the fund, there is no compelling basis to mandate that they receive the same level of scrutiny from boards that is given to a fund's most critical service providers. Rather, fund boards should be allowed to continue to exercise their business judgment in evaluating the extent of scrutiny that a particular service provider merits. Boards are best suited to evaluate the oversight required of any service provider in light of the specific role that the provider plays for a fund and the potential for conflicts of interest inherent in the arrangement.

If you have any questions regarding our letter or would like additional information, please contact Lisa Hamman, Associate Managing Director, at 202-371-5405 or me at 202-326-5463.

Sincerely,

/s/ Thomas T. Kim

Thomas T. Kim
Managing Director
Independent Directors Council

cc: Gary Gensler, Chair, Securities and Exchange Commission
Hester M. Peirce, Commissioner, Securities and Exchange Commission
Caroline A. Crenshaw, Commissioner, Securities and Exchange Commission
Mark T. Uyeda, Commissioner, Securities and Exchange Commission
Jaime Lizárraga, Commissioner, Securities and Exchange Commission