

August 16, 2022

Ms. Vanessa Countryman
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549

Re: Request for Comment on Certain Information Providers Acting as Investment Advisers

Dear Ms. Countryman:

The Investment Company Institute (ICI)¹ welcomes the opportunity to comment on the SEC’s request for comment on information providers.² The release poses many questions exploring whether information providers might meet the definition of “investment adviser” under the Investment Advisers Act of 1940 (Advisers Act) and the Investment Company Act of 1940 (Investment Company Act) and if so, the related implications. We comment on behalf of registered investment companies (“funds”) in their capacity as knowledgeable users of the products and services of index providers and pricing services (“information providers”).³

As a legal matter, it is not at all clear that information providers are “investment advisers” under the Advisers Act and also fail to qualify for applicable exclusions (e.g., the “publisher’s exclusion”). Setting aside that critical legal question, as a matter of policy we do not believe that regulating information providers under the Advisers Act would improve the quality or cost-effectiveness of their products and services. In fact, the related costs likely would be substantial and passed on to clients (e.g., funds and their investors). Notwithstanding our concerns with

¹ The [Investment Company Institute](http://www.ici.org) (ICI) is the leading association representing regulated investment funds. ICI’s mission is to strengthen the foundation of the asset management industry for the ultimate benefit of the long-term individual investor. Its members include mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and UCITS and similar funds offered to investors in Europe, Asia and other jurisdictions. Its members manage total assets of \$28.1 trillion in the United States, serving more than 100 million investors, and an additional \$9.3 trillion in assets outside the United States. ICI has offices in Washington, DC, Brussels, London, and Hong Kong and carries out its international work through [ICI Global](http://www.ici.org).

² *Request for Comment on Certain Information Providers Acting as Investment Advisers*, SEC Release Nos. IA-6050; IC-34618 (June 15, 2022) (the “release”), available at www.sec.gov/rules/other/2022/ia-6050.pdf.

³ We generally do not comment on model portfolio providers in this letter and therefore do not include them in the term “information providers” unless otherwise indicated.

Advisers Act regulation of these entities, if Congress seeks to create a regulatory structure for one or more types of information provider, it must do so in a manner that is tailored to their unique products and services. We address these matters in Section 1 below.

We strongly oppose deeming information providers to be “investment advisers” under the Investment Company Act. As a legal matter, based on the products and services that they typically provide to fund complexes, they do not meet the definition’s requirements. Treating them as such would be immensely burdensome for funds and their investors—it would generate significant upfront and ongoing costs, impede ordinary fund operations, and provide little investor protection. Simply bringing mutual funds into compliance with the Act’s shareholder approval requirements would be enormously costly—*industry-wide we conservatively estimate that these mutual fund proxy costs would range from \$1.3 billion to \$2.0 billion*. These figures do not include exchange-traded funds (ETFs) and closed-end funds, which also would bear proxy costs. Furthermore, extending to these entities the Act’s board approval requirements, affiliated transaction limitations, and compliance obligations would impose significant additional costs and burdens. We address these matters in Section 2 below.

We conclude by discussing the market for index providers’ products and services in Section 3 and how it affects funds. The SEC’s fund disclosure requirements related to performance reporting have limited funds’ choices in selecting indexes. We recommend disclosure amendments that would save fund investors money and help improve market competition.

Finally, we are concerned that the SEC’s Spring 2022 regulatory agenda targets October 2022 for a potential rule proposal for information providers, about two months from the close of this comment period.⁴ In April, ICI and many other trade associations wrote jointly to SEC Chair Gensler, expressing concern that meaningful public input into the rulemaking process was at risk of being lost in the Commission’s current rulemaking agenda.⁵ We appreciate that this release provided a 60-day comment period. However, a comment period of appropriate length is necessary but not sufficient to ensure a fair and informed rulemaking process—the SEC also must review and properly consider the comments it receives. It is difficult to see how the SEC could do so if it intends to publish a proposal in October or shortly thereafter. Indeed, it appears as if the SEC could meet this target only if it has already decided on the proposal’s essential

⁴ The SEC’s Spring 2022 regulatory agenda is available at www.reginfo.gov/public/do/eAgendaMain?operation=OPERATION_GET_AGENCY_RULE_LIST¤tPub=true&agencyCode=&showStage=active&agencyCd=3235&csrf_token=ABBAA84824C29E01B566B0472A6E99E59C730916821A14613C79DE7F48AC8EAEF4CA3A7C929E9B10E667F119BAA4958D5293.

⁵ See *infra*, note 6.

components and the staff has begun drafting it, which of course would greatly diminish the value of this comment process.⁶

Further, in addition to this request for comment, comments also are due today for two significant fund rulemakings: proposed ESG disclosure requirements for funds and advisers and proposed amendments to Rule 35d-1 under the Investment Company Act. We remain deeply concerned that the pace, volume, and complexity of the Commission's simultaneous rulemakings risk harming rather than benefiting funds and their investors.

Here and elsewhere, and in light of all ongoing regulatory activity, the SEC must provide sufficient time for public comment and then carefully analyze and evaluate the comments it receives.

1. ICI Does Not Support Regulating Information Providers as Investment Advisers

The release first provides short descriptions of the information providers.⁷ It then analyzes their "investment adviser" status under the Advisers Act. The Advisers Act definition "generally includes three elements for determining whether a person is an investment adviser: (i) the person provides advice, or issues analyses or reports, concerning securities; (ii) the person is in the business of providing such services; and (iii) the person provides such services for

⁶ We are concerned that the Commission simply does not seem to be taking into account that the pace and complexity of the Commission's simultaneous rulemaking ultimately may ultimately harm, rather than benefit, fund investors. We expressed extreme concern with this approach to rulemaking earlier this year. In April, ICI, along with several other trade associations, submitted a letter to Chair Gensler pointing out that aside from the sheer volume of rulemaking items, the Commission simultaneously was tackling issues that could result in significant shifts in industry operations and practices. The letter also pointed out that "exceedingly short comment periods associated with numerous concurrent potentially interconnected rule proposals that touch on significant changes to the operational and regulatory regime applicable to financial firms could result in rules that hurt investors, damage the financial system, implicate the Commission's obligations under the [Administrative Procedure Act] and internal rulemaking guidelines, and ultimately violate the Commission's tripartite mission." Letter to SEC Chair Gensler from Alternative Credit Council (ACC); Alternative Investment Management Association (AIMA); American Bankers Association (ABA); American Council of Life Insurers (ACLI); American Investment Council (AIC); Banking Policy Institute (BPI); Bond Dealers of America (BDA); FIA Principal Traders Group (FIA PTG); Financial Services Forum (FSF); Institute of International Bankers (IIB); Institute for Portfolio Alternatives (IPA); Investment Adviser Association (IAA); Investment Company Institute (ICI); Loan Syndications and Trading Association (LSTA); Managed Funds Association (MFA); National Association of Corporate Treasurers (NACT); National Association of Investment Companies (NAIC); National Venture Capital Association (NVCA); Real Estate Roundtable (RER); Risk Management Association (RMA); Securities Industry and Financial Markets Association (SIFMA); Securities Industry and Financial Markets Association Asset Management Group (SIFMA AMG); Security Traders Association (STA); Small Business Investor Alliance (SBIA); and U.S. Chamber of Commerce (the Chamber) Center for Capital Markets (CCMC) (April 5, 2022), available at www.ici.org/system/files/2022-04/22-ici-letter-to-sec-chair-gensler.pdf.

⁷ Index providers "compile, create the methodology for, sponsor, administer, and/or license market indexes." Release at 4. Pricing services "provide prices, valuations, and additional data about a particular investment (e.g., a security, a derivative, or another investment), to assist users with determining an appropriate value of the investment." Release at 9.

compensation.”⁸ However, the Act excludes from this definition the “publisher of any bona fide newspaper, news magazine or business or financial publication of general and regular circulation.”⁹

Given the range of products and services that information providers may provide to their various client types, the information providers are best-positioned to conduct the legal analysis necessary to determine if they meet the statutory definition in the first instance or qualify for the publisher’s exclusion. As the SEC notes, “index providers have historically concluded, for example, that, even if they meet the definition of investment adviser, they may rely on the [publisher’s] exclusion and thus need not register with the Commission or be subject to any section of the Advisers Act, including section 206.”¹⁰

However, ICI is well-positioned to address how funds and their advisers use the products and services of these entities and assess the policy merits—both potential benefits and costs—of regulating these entities, under the Advisers Act or otherwise. We do so below.

1.1 The Possible Benefits of Advisers Act Regulation of Information Providers Are Unclear

For funds, the key question is this: Would regulation under the Advisers Act improve the quality or cost-effectiveness of the products and services that information providers offer to fund complexes?

We believe that any benefits are unclear. It is unreasonable to simply assume that extending *any* regulatory framework—including a principles- and disclosure-based statute like the Advisers Act—will improve quality of service. The Advisers Act establishes a federal fiduciary duty for investment advisers¹¹ and promotes good practices—full and fair disclosure to clients, fair treatment of clients, compliance with antifraud provisions and rules. But as discussed below, investment adviser status also carries costs that an entity’s clients may not believe are worth bearing when balanced against any benefits. An indiscriminate extension of the Act to entities outside its scope therefore can do more harm than good. The release identifies no actual harms that Advisers Act regulation would help remedy and barely attempts to identify hypothetical

⁸ Release at 11. *See also* Section 202(a)(11) of the Advisers Act.

⁹ Section 202(a)(11)(D) of the Advisers Act.

¹⁰ Release at 15.

¹¹ *Transamerica Mortgage Advisors, Inc. v. Lewis*, 444 U.S. 11, 17 (1979).

harms,¹² a necessary step for assessing the policy merits of extending the Act to cover these entities.

Also, the use of information providers' products and services—at least by funds—is highly intermediated and scrutinized by sophisticated SEC-regulated entities (e.g., fund advisers and funds). Funds use pricing services in valuing portfolio securities, and their valuation practices are guided by the Investment Company Act, the valuation-related rules thereunder, and accounting standards. A well-functioning valuation process is critically important to funds and their shareholders.¹³ Fund advisers have long been responsible for carrying out the day-to-day functions to value funds' investment portfolios, subject to oversight by fund boards.¹⁴ And as discussed further below, oversight of pricing services has long been a common practice for fund complexes and is now an explicit requirement of Rule 2a-5 under the Investment Company Act.

Funds and their advisers use indexes in several ways.¹⁵ The release's focus appears to be on how *index-based funds* and their advisers use indexes and interact with index providers, and we limit our discussion in this comment letter accordingly. Here too, index-based fund advisers carefully review and conduct due diligence of indexes and their providers in advance of using them for index-based funds and then maintain continued oversight of each.¹⁶ The adviser's overall objective—both in the initial selection and ongoing oversight—is to ensure that the index and its provider are helping meet the needs of its clients (e.g., funds).

1.2 The Costs of New Advisers Act Regulation are Likely to be Passed Along to Clients

We believe that any costs of Advisers Act regulation are likely to be substantial, and highly likely to be passed along to the information providers' clients—for example, as fund expenses borne by fund investors. In addition to imposing substantive requirements, under federal law

¹² The release states only that “[t]hese providers’ operations also raise potential concerns about investor protection and market risk, including, for example, the potential for front-running of trades where the providers and their personnel have advance knowledge of changes to the information they generate and potential conflicts of interest where the providers or their personnel hold investments they value or that are constituents of their indexes or models.” Release at 3-4.

¹³ “Proper valuation, among other things, promotes the purchase and sale of fund shares at fair prices, and helps to avoid dilution of shareholder interests. Improper valuation can cause investors to pay fees that are too high or to base their investment decisions on inaccurate information.” *Good Faith Determinations of Fair Value*, SEC Release No. IC-34128 (Dec. 3, 2020) (“Fair Value Release”), at 5, available at www.sec.gov/rules/final/2020/ic-34128.pdf.

¹⁴ See generally *Fund Valuation Under the SEC’s New Fair Value Rule* (December 2021), ICI (“ICI Valuation Primer”), available at www.ici.org/system/files/2021-12/21-ppr-fund-valuation-primer.pdf.

¹⁵ See generally *Indexes and How Funds and Advisers Use Them: A Primer* (January 2021), ICI (“ICI Index Primer”), available at www.ici.org/doc-server/pdf%3A21_ppr_index_primer.pdf.

¹⁶ See *infra*, Section 2.2.2 for a more detailed discussion.

these entities now would be fiduciaries¹⁷ and subject to the antifraud provisions of the Act (Section 206) and the rules thereunder. There is no reason to think that these tangible costs and the additional liability that attaches to investment adviser status would be fully internalized. To the contrary, we would expect that information providers' contracts with fund complexes and others would reflect the providers' change in legal status. This could increase costs for funds generally (given their widespread use of pricing services and indexes for disclosure purposes¹⁸) and significantly increase costs for index-based funds (given their more extensive use of index data).

As discussed in more detail in Section 3, the possibility of increased costs is particularly concerning with respect to index providers.

Moreover, the large and well-established information providers perhaps could bear the regulatory obligations, but overly burdensome regulations may discourage new entrants, fuel further industry consolidation, or cause some combination of these effects. These markets are already highly concentrated, and regulating these entities as investment advisers potentially will create yet another barrier to entry. These are markets where new and innovative entrants should be encouraged, and regulation could have the opposite effect.

1.3 Any Regulation Must Be Appropriately Tailored

Notwithstanding our concerns with Advisers Act regulation of these entities, if Congress¹⁹ seeks to create a regulatory structure for one or more types of information provider, each such structure must be tailored to their unique products and services. Fund complexes place value in information providers' transparency (especially with respect to underlying methodologies, inputs, assumptions, and changes thereto), disclosure and mitigation of potential conflicts of interest, and maintenance and oversight of internal controls over source data, models, calculations, and dissemination of data to clients. We are not, however, suggesting that information providers are deficient in these respects—rather, these are simply areas of importance for fund complexes.

The SEC must not seek to regulate these entities indirectly by imposing new obligations on those already subject to SEC regulation, e.g., funds and advisers. If the SEC wishes to compel certain activity from information providers, it must do so directly, under clear Congressionally-provided authority, rather than through other means that may be inappropriate, inefficient, and wholly

¹⁷ *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 194 (1963).

¹⁸ For example, Form N-1A requires an open-end fund to compare its performance to an appropriate broad-based securities market index in its prospectus and annual shareholder report. *See supra*, Section 3.

¹⁹ Consideration of whether the SEC currently has authority to create new regulatory structures for these entities is beyond the scope of this letter.

unworkable (e.g., requiring funds or advisers to include certain conditions or representations in their contracts with information providers).²⁰

We also would note that any regulation should take into account and complement existing regulation. For instance, Rule 2a-5 requires a fund adviser²¹ to “[o]versee...pricing service providers, if used, [and] establish...the process for approving, monitoring, and evaluating each pricing service provider and initiating price challenges as appropriate.”²² Were pricing services to be regulated, it would be helpful to have a complementary requirement for pricing services to furnish such information requested pursuant to a fund’s reasonable oversight efforts under Rule 2a-5.²³

Finally, if Congress seeks to regulate index providers, it should be guided by existing principles. Index providers do not operate wholly outside regulation and supporting principles. It is our understanding that the largest US index providers comply with the EU’s Benchmarks Regulation (BMR) and also follow the 2013 recommended practices for benchmark administrators from the International Organization of Securities Commissions (IOSCO).²⁴

If regulation of index providers is determined to be necessary and appropriate, the IOSCO principles could be informative. Their overarching policy objectives—promoting adequate governance (e.g., addressing potential conflicts of interest) and control requirements and the integrity and accuracy of input data—are sound. Similar to the approach taken with credit rating agencies (or nationally recognized statistical rating agencies), Congress first could craft legislation suitable to the information provider type and also provide appropriate rulemaking authority to the SEC.

²⁰ See Letter from Susan Olson, General Counsel, ICI, to Vanessa Countryman, Secretary, SEC, dated July 28, 2022 on the SEC’s proposed cybersecurity risk management program rule, available at www.sec.gov/comments/s7-04-22/s70422-20135041-306062.pdf.

²¹ This assumes that the fund adviser will be the “valuation designee” under the rule, which we expect will generally be the case.

²² Rule 2a-5(a)(4).

²³ Cf. Section 15(c) of the Investment Company Act (“It shall be the duty of the directors of a registered investment company to request and evaluate, and the duty of an investment adviser to such company to furnish, such information as may reasonably be necessary to evaluate the terms of any contract whereby a person undertakes regularly to serve or act as investment adviser of such company.”).

²⁴ *Principles for Financial Benchmarks, Final Report*, IOSCO (July 2013)(“IOSCO Report”), available at www.iosco.org/library/pubdocs/pdf/IOSCOPD415.pdf. The IOSCO Report’s principles are “intended to promote the reliability of Benchmark determinations, and address Benchmark governance, quality and accountability mechanisms.”

1.4 Any Potential Regulation of Information Providers Must Properly Identify Their “Clients”

The release asks several questions meant to determine who an information provider’s “clients” would be under an Advisers Act analysis (Question 29). In the case of a pooled investment vehicle (e.g., a fund), it is the *fund* that is the adviser’s client—not the fund’s investors.²⁵ The adviser manages the fund in accordance with the *fund*’s investment objective, strategies, and policies. As the SEC has stated, “the investment adviser of an investment company need not consider the individual needs of the company’s shareholders when making investment decisions, and thus has no obligation to ensure that each security purchased for the company’s portfolio is an appropriate investment for each shareholder.”²⁶

For information providers—and here, we include model portfolio providers—similar principles should apply when determining the identities of their “clients.” If an information provider has a contractual relationship with an investment adviser or broker-dealer, those entities would be the “clients”—not other entities or individuals (“client’s customers”) that may, through their relationships with investment advisers or broker-dealers, indirectly use or benefit from the information provider’s products or services. Where an information provider has no agreement with a client’s customer, it does not have a client relationship with the customer or any of the obligations that typically flow from an adviser/client relationship under the Advisers Act (e.g., having a reasonable understanding of the client’s objectives to provide advice that is suitable for the client). Of course, investment advisers and broker-dealers still would be subject to their respective SEC standards of conduct when working with their customers.²⁷ These fundamental principles must apply to any regulation of information providers.

2. ICI Strongly Opposes Deeming Information Providers to Be Investment Advisers under the Investment Company Act

The release explains that the Investment Company Act’s definition of “investment adviser” differs from that in the Advisers Act. It then analyzes information providers’ activities with respect to this statute’s definition of “investment adviser.”

²⁵ See *Goldstein v. SEC*, 451 F.3d 873 (D.C. Cir. 2006) (“The fund manager—the adviser—controls the disposition of the pool of capital in the fund. The adviser does not tell the investor how to spend his money; the investor made that decision when he invested in the fund. Having bought into the fund, the investor fades into the background; his role is completely passive.”).

²⁶ *Status of Investment Advisory Programs Under the Investment Company Act of 1940*, SEC Release No. IC-22579; IA-1623, 62 Fed. Reg. 15,098, 15,102 (Mar. 31, 1997).

²⁷ See generally *Commission Interpretation Regarding Standard of Conduct for Investment Advisers*, SEC Release No. IA-5248 (June 5, 2019), available at www.sec.gov/rules/interp/2019/ia-5248.pdf, and *Regulation Best Interest: The Broker-Dealer Standard of Conduct*, SEC Release No. 34-86031 (June 5, 2019), available at www.sec.gov/rules/final/2019/34-86031.pdf.

We strongly oppose deeming information providers to be “investment advisers” under this Act. Determining whether a specific information provider is an “investment adviser” to a fund is an inherently fact-intensive analysis. Based on what we know of the typical contractual arrangements of information providers with fund complexes, however, these entities do not meet the definition’s terms.²⁸ Moreover, there is no policy rationale for reaching to interpret this term so broadly. Doing so would be immensely burdensome for funds and their investors, generating significant upfront and ongoing costs for funds and their investors, impeding ordinary fund operations, and providing little investor protection. Finally, analogizing index providers to fund subadvisers, as some have attempted to do, is inapt. We elaborate on each of these points below.

2.1 Information Providers Do Not Meet the Investment Company Act’s “Investment Adviser” Definition

Section 2(a)(20) of the Investment Company Act states in relevant part:

“Investment adviser” of an investment company means (A) any person... who ***pursuant to contract*** with such ***company regularly furnishes advice*** to such company with respect to the ***desirability of investing in, purchasing or selling securities or other property***, or is ***empowered to determine what securities or other property shall be purchased or sold by such company***, and (B) any other person who ***pursuant to contract*** with a person described in clause (A) ***regularly performs substantially all of the duties undertaken by such person described in clause (A)***; (emphasis added)

Excluded from this definition (among others) are “person[s] whose advice is furnished solely through uniform publications distributed to subscribers thereto” and “person[s] who furnish... only statistical and other factual information..., but without generally furnishing advice or making recommendations regarding the purchase or sale of securities.”

We analyze separately whether pricing services and index providers meet this definition below.

2.1.1 Pricing Services

The SEC has noted the “critical role” that pricing services play in the valuation of fund investments.²⁹ Notwithstanding its importance, the valuation function is distinct and substantially different from portfolio management. A pricing service offers no view regarding whether a fund

²⁸ See *supra*, Section 1. Given the range of products and services that information providers may provide to their clients, the information providers themselves are best-positioned to opine on these legal matters. In this Section 2, we offer our views on the potential applicability of Section 2(a)(20) of the Investment Company Act to information providers based on what we know of their common arrangements with fund complexes, as conveyed to us by our members.

²⁹ Fair Value Release at 32. See also ICI Valuation Primer at 12-13.

ought to buy more of a given investment, continue to hold it, or sell some or all of it—it only provides evaluated prices for a fund’s holdings, which the fund’s adviser acquires on the fund’s behalf.³⁰ The evaluated prices and other related data that pricing services provide to fund complexes clearly do not constitute “advice ... with respect to the desirability of investing in, purchasing or selling securities or other property.” Nor are pricing services “empowered to determine what securities or other property shall be purchased or sold” by a fund. As such they would not meet the definition in Section 2(a)(20)(A). Also, pricing services usually contract not with funds, but with investment advisers, administrators, or other affiliated entities (e.g., at the “enterprise” level), so these arrangements would fail to satisfy Section 2(a)(20)(A) for that reason as well.

Because a pricing service would not “regularly perform...substantially all of the duties undertaken by” a fund’s investment adviser, the pricing service would not satisfy Section 2(a)(20)(B), either. Accordingly, these entities fall well outside this statutory definition.

Finally, while pricing services may offer different packages of data and tools to their clients, the data do not differ among clients—a pricing service provides the same evaluated prices for investments to each of its clients.³¹ Thus, we expect that the “uniform publication” exclusion would be available to pricing services.

2.1.2 Index Providers

Based on the products and services that they customarily provide to fund complexes, index providers also do not meet the definition’s terms and can claim that the “uniform publication” exclusion would apply.

2.1.2.1 Background Information on Fund Complexes’ Use of Indexes

In the investment management context, an index is a list of securities and/or instruments with associated weightings that is designed to represent, measure, or track the performance of a particular financial market (e.g., a stock, bond, or commodity market) or subset of it. While the end product is a list with weightings, an index requires both initial design and ongoing administration pursuant to a methodology, and one or both of these broad responsibilities may be carried out by the index provider.

³⁰ The release asks if there is a distinction between typical pricing services and “valuation specialists.” For certain bespoke or hard-to-value investments, some fund complexes may use specialized appraisers or valuation agents to assist with valuations. For purposes of this letter, we see no meaningful distinction between these valuation entities, and our points on pricing services also apply to valuation specialists.

³¹ The release asks about the price challenge process, but that does not change this analysis. In the event that an investment adviser prevails on a price challenge, the pricing service will adjust its price and disseminate it to all of its clients going forward.

Index providers and their indexes are legally and commercially distinct from funds and fund advisers. This independence is evidenced by the key decisions made within the fund complex, even with respect to index-based funds: deciding to launch an index-based fund, choosing an index for tracking purposes (and, at times, choosing to switch indexes), and determining how the fund will attempt to track that index on a day-to-day basis. The index provider is not advising the independently created and operated index-based fund—in fact, the index provider expressly disclaims such responsibility, which the index-based fund adviser has under its board-approved advisory contract with the fund. Thus, an index-based fund’s creation, its general investment objective and policies seeking to track an index, and how the fund adviser seeks to do so on a day-to-day basis, are independent from the index provider.³²

Funds are legally distinct from their investment advisers and are overseen by boards of directors subject to the Investment Company Act’s independence requirements. Further, all funds are subject to the Act and its related rules, and fund investment advisers are subject to the Advisers Act and its related rules (and applicable provisions of the Investment Company Act and its rules), irrespective of the extent to which they use indexes.³³

2.1.2.2 Applying Index Provider Facts to the Act’s Definition

In light of the above, an index provider does not “regularly furnish... advice to [a fund] with respect to the desirability of investing in, purchasing or selling securities or other property.” Nor is the index provider otherwise “empowered to determine what securities or other property shall be purchased or sold” by the fund—the fund’s *adviser* does so under the agency authority it receives pursuant to its board-approved contract with the fund.

Indeed, the services of an index provider stand in sharp contrast to those of an index-based fund adviser. The fund adviser maintains responsibility for determining how to assemble a portfolio of securities to track the index performance most effectively and efficiently. This requires skill and discretion in deciding when and how to execute portfolio trades. For example, to improve overall tracking and reduce transaction costs, the investment adviser may decide to add or eliminate securities from the portfolio at different times than announced changes to the index in order to mitigate market impact issues associated with transactions in the securities.

And even determining *what* to buy and sell within a fund’s portfolio is not simple. For example, the fund adviser may decide not to add or eliminate certain securities based on index changes to

³² Those fund complexes that use custom indexes have in place other practices and policies designed to eliminate or mitigate potential conflicts of interest that may arise from creating and administering indexes. *See* ICI Index Primer at 9-10.

³³ We also note that the SEC requires even actively-managed funds to use indexes in certain contexts (e.g., to compare their performance to appropriate broad-based securities market indexes in their prospectuses and shareholder reports). *See supra*, Section 3.

the extent that such changes do not meaningfully impact the ability of the fund to track the index's performance. More generally, depending on an index's makeup, certain considerations (e.g., transaction costs, liquidity considerations, legal and regulatory constraints on investing, number of index components) may preclude a fund adviser from even attempting to precisely replicate the index. In these cases, the adviser may take a "representative sampling" approach and hold only a subset of the index's components when such subset represents an effective sample of the index. In the case of ETFs, representative sampling may lead to more efficient pricing and trading of ETF shares in the secondary market. These skills and strategies are especially critical for those funds tracking indexes with thousands of components, where precise replication is impracticable.

A fund adviser also may utilize derivatives or other assets (e.g., ETFs and depositary receipts) that are not contained in an index but provide exposure(s) useful for tracking the index. An adviser also must manage cash to meet redemptions while also ensuring that this cash does not represent a "drag" on performance or increase tracking error. In sum, an index-based fund adviser's duties encompass much more than mechanically following index information.

Also, an index provider does not "regularly perform... substantially all of the duties undertaken" by the fund's investment adviser, as Section 2(a)(20)(B) requires. The traditional functions of a fund adviser extend well beyond portfolio management and include, among others, organizing and preparing materials in connection with board meetings; *ad hoc* reporting to the fund board; overseeing other service providers and administering the fund's compliance program; preparing all SEC filings; ensuring compliance with other applicable federal and state securities, tax, and commodities laws; assuming tasks related to portfolio management, such as proxy voting; assuming responsibility for valuing the fund's portfolio investments and calculating its net asset value on a daily basis; and maintaining the fund's books and records.³⁴ Index providers perform none of these activities for funds.

Section 2(a)(20)(A) (the first part of the definition) also requires that the entity regularly furnish advice "pursuant to [a] contract" with the fund. For fund complexes, agreements with index providers are typically between the index provider and the fund's investment adviser (or at the "enterprise" level with a parent or another affiliated entity). Where this is the case, Section 2(a)(20)(A)'s contractual requirement provision is not met. The agreements then may permit the adviser to use, or sublicense, the relevant indexes for funds that it manages. Furthermore, the agreements are clear that the index providers are not providing investment advice.

We also believe that index providers could avail themselves of either or both relevant exclusions, i.e., the "uniform publications" and "statistical and other factual information" exclusions. If two index provider clients receive information about the same index, the index provider provides the

³⁴ In some cases, fund administrators or other entities may perform certain of these tasks.

same information to each (although the provider could provide additional information to one), i.e., the components and weightings do not differ by client. This also would be the case for the use of broad-based market index information required by the Commission.

2.1.2.3 Consideration of Specialized Indexes

We do not believe that the analysis changes much depending on whether the index that a fund seeks to track is broad-based or specialized.³⁵ The provider of a specialized index still would not be “empowered to determine what securities or other property shall be purchased or sold by such company” or “perform[ing] substantially all of the duties” of the fund’s investment adviser. In addition, any claim that such an index provider is “regularly furnish[ing] advice” to the fund “with respect to the desirability of investing in, purchasing or selling securities or other property” is *weaker*. In the case of specialized indexes, enhanced involvement of the SEC-registered adviser at the set-up phase further reinforces the adviser’s importance and role as fund manager and weakens the policy argument for sweeping index providers into this definition.

2.2 Treating Information Providers as Investment Advisers Under the Investment Company Act Serves No Policy Purpose

Funds are comprehensively regulated under the Investment Company Act. Every fund is overseen by a board of directors. Fund boards review and approve contracts between the fund and its service providers (including the fund’s investment adviser), approve policies and procedures to ensure the fund’s compliance with federal securities laws, and oversee and review the performance of the fund’s operations.

Mutual funds and ETFs generally are managed by SEC-registered investment advisers subject to the requirements of the Advisers Act and the rules thereunder.³⁶ The investment adviser owes fiduciary duties to the fund, and as described above, performs many functions on the fund’s behalf in addition to portfolio management. Oversight of service providers—by the board, the

³⁵ Broad-based and specialized indexes are not distinguishable based on the amount of discretion that the index provider might retain. Relatively speaking, a broad-based index could leave more room for discretionary decision making by the index provider, and a specialized index could be heavily rule-based.

³⁶ An exceedingly small number of funds are “internally managed” and do not rely on external investment advisers. We are aware of no internally managed index-based funds, however. Unit investment trusts (UITs) also operate without investment advisers.

investment adviser, or both—is essential to the fund structure, as a matter of law and well-developed policies and practices. We discuss each information provider in more detail below.

2.2.1 Pricing Services

Even before the SEC adopted Rule 2a-5 in 2020, oversight of pricing services by fund complexes was common practice. This rule provision largely codifies existing practice and is generally consistent with prior regulatory statements.³⁷

Rule 2a-5 expressly requires a fund to “[o]versee...pricing service providers, if used, [and] establish...the process for approving, monitoring, and evaluating each pricing service provider and initiating price challenges as appropriate.” The Fair Value Release also includes factors that valuation designees should consider before deciding to use a pricing service.³⁸ While fund advisers will carry out these functions in most cases, the rule contemplates an oversight role for fund boards as well. As part of the quarterly reporting framework, boards will receive reporting on (i) any material changes in conflicts of interest of a service provider; and (ii) “[a]ny material changes to the valuation designee’s process for selecting and overseeing pricing services, as well as any material events related to the valuation designee’s oversight of pricing services....”³⁹ Furthermore, the SEC makes clear that the annual review of the adequacy and effectiveness of the fair value process should include an “adequacy and effectiveness” assessment of the pricing services used.⁴⁰

In sum, Rule 2a-5’s treatment of pricing services is thorough and properly tailored to the needs of funds and their investors. The ICI Valuation Primer outlines funds’ current oversight practices in this area, which again pre-date the rule’s adoption.⁴¹ If anything, we expect oversight practices to be further enhanced now that the rule’s compliance date is imminent. Subjecting these entities to additional requirements and restrictions under the Investment Company Act would not further any policy objective.

³⁷ The SEC noted in the adopting release for Rule 38a-1 that limiting the service providers named in Rule 38a-1—investment advisers, principal underwriters, administrators, and transfer agents—did not lessen a fund’s obligation to consider compliance as part of its decision to employ other entities, such as pricing services. *Compliance Programs of Investment Companies and Investment Advisers*, SEC Release No. IC-26299 (Dec. 17, 2003) (“Compliance Rules Adopting Release”), at n.28, available at www.sec.gov/rules/final/ia-2204.htm#P140_42493.

³⁸ Fair Value Release at 37-38.

³⁹ Rule 2a-5(b)(1)(i)(A)(2)(i) and (iii).

⁴⁰ Fair Value Release at 35.

⁴¹ ICI Valuation Primer at 25-28.

2.2.2 Index Providers

The index-based fund adviser's due diligence of an index provider and the relevant index is most intense at the product design and fund launch phase. As a threshold matter, the adviser must understand the index (e.g., its exposures, performance history, underlying methodology, and the data and assumptions upon which it depends and operates). The adviser also must satisfy itself that the index would provide quality coverage or exposure to the market segment which would help investors meet certain investment objectives.⁴² The fund adviser also must be confident that the index provider has the skill and resources to properly administer the index and disseminate related information in a timely manner. Boards also may receive and consider summaries of this information prior to approving the launch of an index-based fund. More generally, boards may evaluate the adviser's process and criteria for selecting the index and index provider, as well as the nature of the adviser's anticipated ongoing oversight of each.

A fund adviser then maintains oversight of the index and index provider. We have discussed above the extensive and multi-faceted nature of an index-based fund adviser's portfolio management responsibilities,⁴³ which necessarily requires detailed knowledge of the index provider, the index, and relevant changes to each. In connection with portfolio management and general vendor due diligence, this oversight is often "exception-based," and if the adviser spots potential issues with administration of an index (e.g., changes to the components that appear to be inconsistent with the index's methodology), the adviser will reach out to the index provider and investigate. Depending on the outcome (e.g., if an error is material), the adviser may report these events to the fund's board. On an ongoing basis, the fund adviser also may conduct annual reviews of the index providers' controls.

An index provider generally has procedural means of changing an index's methodology. Index providers typically have governance processes that guide these changes, and in some cases the index providers will solicit input broadly from users (including investment advisers) prior to making any final changes. These consultations are beneficial in that they allow market participants to raise concerns (e.g., regarding an index's investability) and highlight potential impacts that the index provider may not have considered.

Finally, an investment adviser may seek to change the index that a fund tracks. The adviser may believe that a different index could provide more appropriate (or investable) investment exposure; that a different index provider could provide better support; or that an alternative arrangement would be more cost effective. Because an index change would also impact the

⁴² For instance, an index also must be sufficiently "investable"—this may be affected by legal and regulatory constraints on investing (e.g., a country may prohibit its investors from transacting in certain securities), or trading or liquidity limitations that make investing in certain securities costly or impracticable.

⁴³ See *supra*, Section 2.1.2.2.

fund's investment objective and strategies, such an action would be subject to board review and approval.

In sum, advisers to index-based funds and the funds' boards recognize that oversight of indexes and index providers is part of their fiduciary duty of care to the fund.

2.3 Treating These Entities as Investment Advisers Would Trigger Burdensome Requirements and Limitations

The release notes that status as an investment adviser under the Investment Company Act

may trigger prohibitions related to self-dealing and other types of overreaching of a fund by its affiliates (including its investment adviser), ineligibility criteria for certain affiliated persons (including investment advisers), and requirements related to the approval of compliance procedures and practices by the fund's board of directors. In addition, the Investment Company Act contains specific requirements related to shareholder and board approval of the fund's advisory contract (including of any assignment of the contract).⁴⁴

Beyond this, the release does not discuss the ramifications of treating information providers as investment advisers under the Act.

In fact, the consequences for funds would be severe and costly and offer little to no offsetting investor protection benefits. Below, we discuss the impact in three areas: shareholder and board approvals of investment advisory agreements; compliance with Rule 38a-1; and compliance with the Investment Company Act's limitations on affiliated transactions.⁴⁵

2.3.1 Requiring Shareholder Approval of Contractual Arrangements Would Be Enormously Costly, Harming Funds and Their Investors

If pricing services and/or index providers were deemed "investment advisers," contracts with these entities would be subject to shareholder approval under Section 15(a) of the Act. Requiring shareholder approval of these arrangements would be extremely costly. Like operating companies, funds prepare proxy materials and seek shareholder approvals in connection with their shareholder meetings. In many respects, however, the accompanying challenges for funds are unique and more daunting than those for other issuers, primarily due to:

- Funds' diffuse and retail-oriented shareholder bases;

⁴⁴ Release at 28-29.

⁴⁵ For purposes of using indexes to meet the Commission's requirements in Form N-1A (discussed in Section 3), we also question the benefits and note that any costs would be passed along to fund investors.

- Retail shareholders’ relatively low proxy voting participation rates; and
- Severe legal and other impediments to communicating directly with fund shareholders.

These challenges are exacerbated by the Investment Company Act itself, specifically its requirement that shareholders approve investment advisory agreements with a “1940 Act majority.”⁴⁶

We previously have outlined in detail these difficulties, the costs they impose, and how the SEC could remedy them.⁴⁷ Commissioner Peirce and former Commissioner Lee recognized the need to reform the fund proxy system. Commissioner Peirce rightly refers to rules to reform the fund proxy system as part of the SEC’s “important mission-focused” work.⁴⁸ In 2021, then-Acting Chair Lee noted that the “unique problems [of fund proxy campaigns] translate into increased expenses for funds to carry out their regulatory obligations to obtain shareholder approval for...certain agreements” and that “problems [funds face in] obtaining a quorum...deserve attention as we examine and attempt to modernize our proxy voting system.”⁴⁹

The SEC asks about the economic costs associated with concluding that these information providers meet the definition of “investment adviser” under the Investment Company Act. Interpreting the Investment Company Act in novel ways that would *broaden* funds’ shareholder approval obligations would make a bad situation worse. Simply bringing mutual funds into compliance with Section 15(a)’s shareholder approval requirements would be enormously costly—*industry-wide we conservatively estimate that these mutual fund proxy costs would range from \$1.3 billion to \$2.0 billion.*⁵⁰ This range is at the low end of reasonably expected total *industry* fund proxy costs for the following reasons:

⁴⁶ Section 2(a)(42) defines this as “the vote, at the annual or a special meeting of the security holders of such company duly called, (A) of 67 per centum or more of the voting securities present at such meeting, if the holders of more than 50 per centum of the outstanding voting securities of such company are present or represented by proxy; or (B) of more than 50 per centum of the outstanding voting securities of such company, whichever is the less.” Funds generally obtain approvals by achieving at least 67 percent support from greater than 50 percent of shares outstanding.

⁴⁷ *Analysis of Fund Proxy Campaigns: 2012–2019*, ICI (December 2019) (“ICI Fund Proxy Analysis”), available at www.sec.gov/comments/4-725/4725-6580709-201124.pdf; and Letter to Vanessa Countryman, Acting Secretary, US Securities and Exchange Commission, from Paul Schott Stevens, President and CEO, ICI, dated June 11, 2019, available at www.sec.gov/comments/4-725/4725-5658296-185774.pdf.

⁴⁸ *Rip Current Rulemakings: Statement on the Regulatory Flexibility Agenda*, Commissioner Hester Peirce (June 22, 2022), available at www.sec.gov/news/statement/peirce-statement-regulatory-flexibility-agenda-062222.

⁴⁹ *Every Vote Counts: The Importance of Fund Voting and Disclosure*, Acting Chair Allison Herren Lee (Mar. 17, 2021), available at www.sec.gov/news/speech/lee-every-vote-counts.

⁵⁰ The low end of this range is estimated by taking the average mutual fund proxy cost per shareholder account for a slate that included a non-routine item in July 2006 (\$4.37) and multiplying it by the number of mutual fund shareholder accounts as of March 2022 (305.6 million), or $\$4.37 \times 305.6 \text{ million} = \1.3 billion . The average fund

- Proxy costs for ETFs and closed-end funds are not included;⁵¹
- Processing fees associated with proxies that would be assessed under the current NYSE fee schedule are not fully captured;⁵² and
- The number of shareholder accounts is understated because of omnibus accounting.⁵³

Our analysis of fund proxy campaigns from 2012 to 2019 that included at least one “1940 Act Majority” item (a category that includes approvals of investment advisory agreements) confirmed that these campaigns are costly and challenging to conduct.⁵⁴ Among the highlights from that analysis:

- Cost estimates for 145 separate campaigns (which in many instances were *not* complex-wide) totaled \$373 million.
- Applying the follow-up solicitation cost estimates (in percentages) provided by respondents to each respondent’s estimated campaign costs (in dollars), the overall high-end estimate of follow-up solicitation costs is \$229 million (or 61 percent of total

proxy cost per shareholder is from an ICI study published in December 2006, “Costs of Eliminating Discretionary Broker Voting on Uncontested Elections of Investment Company Directors,” available at www.ici.org/doc-server/pdf%3Awht_broker_voting.pdf. Although 16 years old, the all-in fund proxy cost per shareholder account in the report is the most comprehensive measure of proxy costs published to date. The estimated number of shareholder accounts for March 2022 is from an ICI statistical collection on supplementary mutual funds data. Because of fund complexes’ widespread use of pricing services in particular, we assume that all mutual funds would conduct proxy campaigns to obtain the necessary shareholder approvals of pricing services and also index providers (if applicable).

The upper end of this range reflects an inflation adjustment on the average mutual fund proxy cost per shareholder account since July 2006. Specifically, the \$4.37 average mutual fund proxy cost per shareholder account from July 2006 is adjusted by the 49.8 percent increase in the Producer Price Index, less food and energy from July 2006 to June 2022, resulting in an inflation-adjusted average mutual fund proxy cost per shareholder account of \$6.55 ($\$4.37 \times 1.498 = \6.55). After adjusting for inflation, we estimate proxy costs associated with applying Section 15(a)’s shareholder approval requirements to pricing services and index providers to be at least \$2.0 billion ($\$6.55 \times 305.6 \text{ million} = \2.0 billion).

⁵¹ ICI does not have data on the number of shareholder accounts associated with ETFs and closed-end funds. These funds also would need to comply with Section 15(a)’s shareholder approval requirements.

⁵² The \$4.37 average mutual fund proxy cost per shareholder account captured processing fees associated with proxies that were in effect in 2006. Since 2006, the NYSE has increased the fees associated with proxies.

⁵³ The ICI figure of 305.6 million mutual fund shareholder accounts as of March 2022 understates the actual number of shareholder accounts because of the prevalence of omnibus accounting. In omnibus accounting, individual shareholder accounts are aggregated into one omnibus account that appears on the books of a mutual fund. It is a common practice for financial intermediaries such as brokers, fund supermarkets, and investment advisory firms to have one omnibus account through which thousands of individuals may hold shares in one fund. Yet, when a mutual fund requires shareholder approval of an item, all of its beneficial owners ultimately must receive proxies, irrespective of whether their shares are held through omnibus accounts.

⁵⁴ Our analysis was based on a member survey conducted in 2019. Sixty-four ICI member firms responded, representing over \$18 trillion, or approximately 76 percent, of US-registered fund assets. For more information on the survey and our analysis, *see generally* ICI Fund Proxy Analysis, *supra* note 47.

campaign costs provided by respondents), and the low-end estimate is \$158 million (or 42 percent of total campaign costs provided by respondents).⁵⁵

- Thirty-eight percent of reported proposals required at least one meeting adjournment to reach quorum, meaning that the affected fund(s) had to reconvene the meeting later (in some cases, multiple times) to resolve the proxy matter.
- Eighty-three percent of respondents diverted resources to support proxy campaigns.

The relative difficulty, and associated costs, of proxy campaigns to approve information providers would be high, due to fund shareholder voting behavior and the demanding statutory approval requirement. And the campaigns' purpose would not be at all intuitive for fund investors. For each type of information provider, shareholders likely would not understand why they were being asked to approve "investment advisers" that:

- are distinct from the *fund* adviser with which they are familiar;
- do not actually manage their funds; and
- are already providing services, possibly dating back to the fund's inception.

To obtain these vital approvals—as we discuss below, failure would not be a viable option—multiple costly solicitations would be the norm.

In effect, funds would be seeking shareholder ratification of existing arrangements, which raises difficult questions about how a fund should proceed if it does *not* obtain these approvals. What happens if a fund fails to obtain shareholder approval of its pricing service(s)? Failure would almost certainly be due to the general difficulties of fund proxy campaigns (usually due to difficulties reaching quorum), rather than broad affirmative shareholder disapproval of current pricing services. Would the fund adviser then need to internally assume all responsibilities for which it has relied on pricing services for decades? This obviously would generate costs much greater than those of a failed proxy campaign.

Similarly, what happens if an index-based fund fails to obtain shareholder approval of the relevant index provider? If a fund is unable to obtain an approval of an index provider, would the adviser be required to begin actively managing the fund? If a fund's investment objective of tracking an index were itself a fundamental policy, would the fund then conduct another proxy campaign to obtain shareholder approval to change *that*? Would relevant fund disclosures (e.g., the prospectus) need to be amended and distributed to shareholders? A failure to obtain this initial approval would significantly change a fund's investment objective and strategies and

⁵⁵ Follow-up solicitation costs are one way to fairly assess some of the costs that funds incur when "chasing quorum" to satisfy the 1940 Act's approval standards.

likely lead to transaction costs and capital gains as the portfolio transitions to a new objective and strategies—which, ironically, most shareholders might not favor.

Nor would grandfathering existing arrangements resolve our concerns. Requiring shareholder approval of new arrangements with information providers also would have pernicious effects. We know that the fund proxy system’s high costs and challenges deter or delay decisions related to fund policies, governance, and operations.⁵⁶ If replacing information providers required shareholder approval, funds would have a new reason to simply maintain the status quo. This risks further entrenching the incumbent information providers and undermining efforts to improve valuation and index-based funds’ operations. The release notes SEC staff observations from circa 2008 of “compliance issues in connection with registrants’ interactions with third-party pricing services.”⁵⁷ However, Rule 2a-5 wisely avoids creating significant frictions for replacing pricing services when the valuation designee deems it appropriate.⁵⁸ Requiring shareholder approval of new pricing services would undermine this key aspect of the new rule.

Finally, the shareholder approval burdens would be even worse for UITs.⁵⁹ UITs by definition do not have boards of directors⁶⁰ and by operation have not customarily had investment advisers, so deeming pricing services and index providers to be “investment advisers” raises the question of how UITs would comply with Section 15(a) under the Act. Specifically, Section 15(a)(2) states that an investment advisory contract “shall continue in effect for a period more than two years from the date of its execution, only so long as such continuance is specifically approved at least annually by the board of directors or by vote of a majority of the outstanding voting securities of such company.” Other funds typically comply with this provision by having their boards approve their investment advisory contracts annually, but because UITs do not have boards, this annual approval obligation presumably would fall to the UITs’ shareholders. At best, this annual shareholder proxy requirement would add significant new annual costs and burdens to these UITs, which typically are low-cost vehicles. At worst, it could make continued operation of UITs impossible if the shareholders did not provide the requisite approvals on an annual basis.

⁵⁶ See ICI Fund Proxy Analysis at 16-21.

⁵⁷ Release at 11.

⁵⁸ See *supra*, Section 2.2.1 for a summary of the related rule requirements.

⁵⁹ Generally speaking, a UIT’s trust indenture designates a depositor (also known as the sponsor), a trustee, and an evaluator. The depositor is generally responsible for assembling the trust’s portfolio and distributing the trust’s units during an initial offering period. The trustee, which must be a bank under the Investment Company Act, keeps custody of the trust’s securities and maintains the accounts and record of the trust. The evaluator values the trust’s securities.

⁶⁰ Section 4(2) of the Investment Company Act.

2.3.2 Applying Board Approval Requirements to These Entities Would Be Unnecessarily Burdensome

Section 15 of the Investment Company Act also requires board approval of investment advisory agreements, initially and annually thereafter. As discussed above, Rule 2a-5 requires board and adviser oversight of pricing services, so layering the Section 15 board approval process on top of these rule requirements would be duplicative and unnecessary. Requiring annual board approvals of pricing services would undermine one of Rule 2a-5’s key policy purposes, i.e., allowing fund boards to designate performance of fair value determinations—including its required elements, such as approving, monitoring, and evaluating pricing services—to a valuation designee, subject to continued board oversight. Indeed, in 2020 the SEC considered but decided against including a specific requirement in Rule 2a-5 for a fund’s board or adviser, as applicable, to periodically review the selection of pricing services and to evaluate other pricing services, finding such a requirement unnecessary in light of the rule’s other requirements.⁶¹

Board approval requirements for index providers similarly is unnecessary. Both the Investment Company Act and fiduciary duties under state law require board oversight of investment advisers (as traditionally understood), and boards’ practices in this area are well-developed. A board’s consideration of the “nature and quality of the services provided to the fund and shareholders” by an investment adviser⁶² typically captures all key services that the adviser provides to the fund, including the adviser’s oversight of other important entities with which it contracts and any other key fund service providers.

The Investment Company Act and the rules thereunder account for fund service providers. Specific requirements are calibrated, including for the oversight of those deemed most important. Named entities in the Act include investment advisers, principal underwriters, and independent public accountants; named entities in the rules include pricing services (Rule 2a-5) and investment advisers, principal underwriters, administrators, and transfer agents (Rule 38a-1). If, based on law and practice, we were to assign a single entity to the top of this fund service provider hierarchy, it would be investment advisers, given the significant and multi-faceted nature of the work they do on behalf of funds. Thus, the focus of the Act and its rules on investment advisers is entirely appropriate, including requiring registration under the Advisers Act.

What would *not* be appropriate is stretching the meaning of “investment adviser” beyond recognition as a means of directly or indirectly imposing substantive requirements on information providers that are disproportionate to their relative importance and role in the service provider hierarchy. Nor are such overbroad interpretations necessary. Neither investment

⁶¹ See *supra*, note 40 and accompanying text.

⁶² See *Gartenberg v. Merrill Lynch Asset Management*, 694 F.2d 923, at 930 (2d Cir. 1982).

advisers nor boards⁶³ take the view that their oversight obligations extend *only* to those entities expressly identified in the Act and rules thereunder. Fund complexes understand the importance of broad service provider oversight, as part of sound business practice (e.g., it may reduce costs and improve operational efficiencies) and risk management (e.g., operational, business resiliency, financial, legal and compliance, and reputational). While this oversight is certainly shaped by legal and regulatory requirements, fund complexes need flexibility in conducting it (e.g., by permitting them to commit resources and conduct oversight based on the relative importance of and risks related to the services provided). The importance of service providers and how they are used are not uniform across fund complexes.

If the SEC wishes to ensure that fund service providers such as index providers are subject to appropriate oversight, it could take more targeted actions, as it has done for other service providers. For instance, the SEC noted in the Rule 38a-1 adopting release that limiting the service providers named in the rule—investment advisers, principal underwriters, administrators, and transfer agents—did not lessen a fund’s obligation to consider compliance as part of its decision to employ other entities, such as pricing services, auditors, and custodians.⁶⁴ And while the SEC does not regulate proxy advisory firms as such, it has provided guidance to investment advisers about their use of proxy advisory firms.⁶⁵ This guidance also recognizes that oversight of proxy advisory firms depends in large part on the type of functions and services that the investment adviser has retained the proxy advisory firm to perform.⁶⁶

2.3.3 Extending Rule 38a-1 Would Be Unnecessary

For many of the reasons set forth above, extending the requirements of Rule 38a-1 to these information providers also would yield little benefit. “Oversight” and “compliance oversight” should not be conflated. As discussed above, not every service provider warrants the same degree of compliance-oriented review that Rule 38a-1 demands with respect to the investment advisers, principal underwriters, administrators, and transfer agents. The Fair Value Release discusses the connection between Rule 2a-5 and Rule 38a-1 and is clear about the rules’ distinct purposes and requirements, pointing out that “[w]hile the compliance rule separately requires the fund’s chief

⁶³ See generally *Board Oversight of Certain Service Providers*, Independent Directors Council Task Force Report, June 2007, available at www.idc.org/pdf/21229.pdf. See also *Report on Funds’ Use of Proxy Advisory Firms*, Investment Company Institute and Independent Directors Council (January 2015), available at www.ici.org/pdf/pub_15_proxy_advisory_firms.pdf. (“The board’s oversight practices with respect to proxy advisory firms generally flow from its oversight practices for proxy voting and service providers generally.”)

⁶⁴ See *supra*, note 37. See also SEC Division of Investment Management Guidance Update, *Business Continuity Planning for Registered Investment Companies* (June 2016), available at www.sec.gov/investment/im-guidance-2016-04.pdf (providing the staff’s view on “critical fund service providers” beyond those named in Rule 38a-1).

⁶⁵ *Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers*, SEC Release No. IA-5325 (Aug. 21, 2019), at 17-23, available at www.sec.gov/rules/interp/2019/ia-5325.pdf.

⁶⁶ *Id.* at 20.

compliance officer (“CCO”) to provide an annual report to the fund’s board that addresses the operation of these [fair valuation] policies and procedures..., rule 2a-5’s reporting requirements address a different set of concerns.”⁶⁷ The compliance function may have a role to play in overseeing pricing services, but it is not central to these overall efforts, as is evident by the rule’s allowing only primary investment advisers (rather than, say, the CCO or compliance personnel generally) to serve as “valuation designees” and the Fair Value Release’s guidance on selecting pricing services.⁶⁸

Extending Rule 38a-1’s requirements to include index providers is unnecessary. As discussed above, index-based fund advisers maintain oversight of index providers and the relevant indexes. These advisers are subject to Rule 206(4)-7, which requires certain compliance procedures and practices for registered investment advisers. In the Compliance Rules Adopting Release, the SEC stated that it expected an adviser’s policies and procedures, at a minimum, to address, among other issues, “[p]ortfolio management processes, including allocation of investment opportunities among clients and consistency of portfolios with clients’ investment objectives, disclosures by the adviser, and applicable regulatory restrictions.” In addition, Rule 38a-1 (the fund compliance rule) covers investment advisers, providing another layer of oversight of the entities that oversee index providers.

2.3.4 Extending Affiliated Transactions Limitations Would Unreasonably Restrict Fund Operations

Deeming information providers to be “investment advisers” under the Investment Company Act would greatly harm fund investors by restricting the entities with which funds could transact and conduct ordinary business. The Investment Company Act automatically deems an investment adviser of a fund to be an “affiliated person” of that fund (a “first-tier affiliate”),⁶⁹ and prohibits that fund from engaging in both principal and joint transactions with a first-tier affiliate, or an affiliated person of a first-tier affiliate (a “second-tier affiliate”).⁷⁰ The Act also precludes a fund

⁶⁷ Fair Value Release at n.130.

⁶⁸ *See supra*, note 38 and accompanying text. *See also* ICI Valuation Primer at 24-28.

⁶⁹ Section 2(a)(3)(E) of the Investment Company Act. Other “affiliated persons” include “(A) any person directly or indirectly owning, controlling, or holding with power to vote, 5 per centum or more of the outstanding voting securities of such other person; (B) any person 5 per centum or more of whose outstanding voting securities are directly or indirectly owned, controlled, or held with power to vote, by such other person; (C) any person directly or indirectly controlling, controlled by, or under common control with, such other person; (D) any officer, director, partner, copartner, or employee of such other person; ... and (F) if such other person is an unincorporated investment company not having a board of directors, the depositor thereof.”

⁷⁰ Section 17(a) of the Act prohibits any first- or second-tier affiliate of a fund from selling securities to, or purchasing securities from, the fund. Section 17(d) makes it unlawful for first- and second-tier affiliates of a fund, the fund’s principal underwriters, and affiliated persons of the fund’s principal underwriters, acting as principal, to effect any transaction in which the fund or a company controlled by the fund is a joint or a joint and several

from borrowing from or lending to a first- or second-tier affiliate, even if the terms to the fund are most favorable.

In addition, the Act:

- Prohibits a fund from purchasing securities in a primary offering if certain affiliated persons of the fund are members of the underwriting or selling syndicate (Section 10(f));⁷¹
- Limits the remuneration that affiliated persons of a fund may receive in transactions involving the fund (Section 17(e));⁷² and
- Prohibits a fund from acquiring securities issued by, among others, its own investment adviser (Section 12(d)(3)).⁷³

The policy purpose behind these prohibitions and limitations is clear: they are designed to prevent affiliated persons from managing the fund's assets for their own benefit (i.e., overreaching), rather than for the benefit of the fund's shareholders.

In practice these prohibitions and limitations can be blunt and, perhaps unintentionally, detrimental to funds and their investors. A seminal article on the Investment Company Act recognized this, stating that

participant "in contravention of such rules and regulations as the Commission may prescribe for the purpose of limiting or preventing participation by such registered or controlled company on a basis different from or less advantageous than that of such other participant." Rule 17d-1(a) prohibits first- and second-tier affiliates of a fund, the fund's principal underwriter, and affiliated persons of the fund's principal underwriter, acting as principal, from participating in or effecting any transaction in connection with any joint enterprise or other joint arrangement or profit-sharing plan in which any such fund or company controlled by a fund is a participant "unless an application regarding such joint enterprise, arrangement or profit-sharing plan has been filed with the Commission and has been granted."

⁷¹ Rule 10f-3 under the Investment Company Act provides an exemption from Section 10(f) under certain limited conditions.

⁷² Section 17(e)(1) of the Act prohibits an affiliated person acting as agent from accepting any compensation from any source (other than a regular salary or wage from a fund) for the purchase or sale of property to or for the fund, or companies controlled by the fund, except in the course of the person's business as an underwriter or broker. Section 17(e)(2) of the Act limits the remuneration that a person may receive when acting in reliance on Section 17(e)(1)'s exemption for the brokerage business. Rule 17e-1 describes the circumstances in which remuneration received by an affiliated person of a fund qualifies as the "usual and customary broker's commission."

⁷³ Section 12(d)(3) of the Act generally prohibits any fund from purchasing or acquiring any security issued by or any other interest in the business of any person who is a broker, a dealer, is engaged in the business of underwriting, or is either an investment adviser of an investment company or an investment adviser registered under the Advisers Act. Rule 12d3-1 provides an exemption from this general prohibition, but the exemption does not include securities issued by a subadviser (or an affiliated person of a subadviser) if the subadviser is "responsible for providing advice with respect to the portion of the acquiring company that is acquiring the securities."

[a]ny sweeping prohibition may involve hardship and unreasonable restraints and instead of protecting stockholders may, in specific cases, work to their disadvantage by preventing desirable transactions.⁷⁴

If information providers are deemed to be “investment advisers,” the potential reach of these statutory provisions would be staggering. Although direct fund transactions with an information provider occur infrequently, transactions with *affiliates* of an information provider may occur often, especially when the information provider is under the control of a large financial conglomerate.⁷⁵ When the SEC addressed affiliated transaction issues with respect to subadvised funds via rulemaking in 2002,⁷⁶ it noted

Since 1940, the number of persons who are either first-tier or second-tier affiliates of a fund has grown markedly for a number of reasons. First, as funds have grown larger, they are more likely to own positions in excess of five percent of the voting securities of an issuer, creating ‘portfolio affiliates.’ Second, many funds today use subadvisers to help manage fund assets, making each subadviser an affiliate of the fund and persons affiliated with each subadviser second-tier affiliates of the fund. Third, most funds are today organized into complexes under the common control of an adviser (or other person), making each fund an affiliated person of all of the other funds in the complex. When multiple funds with subadvisers and portfolio affiliates are under common control, the number of potential first- and second-tier affiliated persons can be quite large.

These trends have not reversed since the early 2000s, and calling pricing services or index providers “investment advisers” would magnify, and significantly accelerate, the “creep” of fund affiliates. As noted above, funds need and use pricing services, and given the concentration of the industry, funds generally use the same handful of providers. A single fund may use multiple pricing services to help determine the value of a wide array of its investments.⁷⁷ The largest pricing services, if deemed to be “investment advisers,” would become first-tier affiliates of thousands of funds, and each entity under common control with a pricing service would be a second-tier affiliate of those funds, prohibiting funds from engaging in the transactions described above with those entities. To the extent that a fund currently transacts with an affiliate of a pricing service to execute fixed-income or equity trades or acquire securities in an underwriting, or wishes to invest in the securities issued by an affiliate, it would be limited in its ability to do

⁷⁴ Alfred Jaretzki Jr., *The Investment Company Act of 1940*, 26 Wash. U. L. Q. 303, 321 (1941).

⁷⁵ For a sense of the challenges that the Act’s affiliated transaction prohibitions can create for fund complexes using advisers that are affiliates of large financial institutions, see *Salomon Brothers Inc.*, SEC Staff No-Action Letter (pub. avail. May 26, 1995), available at www.sec.gov/divisions/investment/noaction/1995/salomonbrothers042595.pdf.

⁷⁶ *Transactions of Investment Companies With Portfolio and Subadvisory Affiliates*, SEC Release No. IC-25557 (Apr. 30, 2002), available at www.sec.gov/rules/proposed/ic-25557.htm#P55_10945.

⁷⁷ See ICI Valuation Primer at 26 (noting that funds often assign different pricing services to different asset classes or use pricing services in a secondary or tertiary capacity).

so. The issue may be particularly acute for certain portfolio securities, as consolidation in the financial services industry (particularly in the broker-dealer segment of the industry) has resulted in a few major broker-dealers accounting for a large percentage of the market share of trading in certain asset classes.⁷⁸ Funds would be forced to make difficult, costly, and unnecessary trade-offs in areas such as valuation, best execution, and portfolio construction, to the detriment of fund investors. And if these information providers consolidate or are acquired by large financial institutions, the situation would become more dire.

While the affiliation issues created by treating index providers as investment advisers would not be as severe for index-based funds, they too would present a new and complex web of limitations and trade-offs for funds to manage in their index provider arrangements. The larger index providers now would be first-tier affiliates of hundreds of funds, hamstringing funds wishing to transact with their affiliates in similar ways.

Moreover, Rule 17a-10 and the rule amendments that the SEC adopted in 2003 to ease the Act's affiliated transaction burdens on subadvised funds⁷⁹ would be of limited value in this context, due to the large number of new first-tier affiliates that funds would have (i.e., information providers would be deemed to be "providing advice" to a very large number of funds, significantly reducing the benefits of the relief). From a policy perspective, these limitations would be hard to justify, given that pricing services and index providers would have little ability to "overreach," even in cases where they are supposedly "advising" a fund (e.g., they would not be determining the brokers and dealers through which the fund would execute its trades).

The inability to rely on the existing (limited) exemptive rules would mean that funds would have to either cease to engage in these otherwise benign transactions permanently, harming fund shareholders, or seek some form of relief to engage in them. Seeking non-routine relief for these transactions could take months or years to obtain, all while negatively impacting shareholders who would be unreasonably deprived of benefiting from such transactions. This result would be particularly unfortunate, given that otherwise unaffiliated information providers that perform services for fund complexes on an arms' length basis would have little ability to cause a fund to transact with a second-tier affiliate.

We are particularly concerned about the prospect of fund investors being disadvantaged in light of a recent SEC action limiting funds' ability to engage in affiliated transaction that have long

⁷⁸ See, e.g., Columbia ETF Trust, Investment Company Act Release No. 30260 (Notice) (Nov. 13, 2012) and 30301 (Order) (Dec. 11, 2012) (providing relief to affiliated broker-dealers to engage in principal transactions with certain funds because those broker-dealers accounted for a sizable portion of the market share of certain asset classes).

⁷⁹ *Transactions of Investment Companies With Portfolio and Subadviser Affiliates*, SEC Release No. IC-25888 (Jan. 14, 2003), available at www.sec.gov/rules/final/ic-25888.htm.

benefited fund investors. Specifically, the SEC limited cross trading of fixed-income securities pursuant to Rule 17a-7 (the cross trading rule) through guidance in the Fair Value Release.⁸⁰

Both the SEC and its staff affirmatively indicated that they would continue work on the cross trading rule.⁸¹ To inform this regulatory initiative, ICI and others provided policy recommendations supported by detailed data⁸²—for example, ICI provided data estimating that cross trading of fixed-income securities saved funds and their shareholders nearly \$329 million in 2020 and advisers’ clients generally over \$390 million.⁸³

Despite this, the SEC inexplicably eliminated cross trading rule reform from its December 2021 rulemaking agenda. We note that it did so over the objections of two SEC Commissioners⁸⁴ and after ICI had submitted additional cross trade data in October 2021.⁸⁵

Our experience with the cross trading rule—and fund proxy reform, which the SEC also recently dropped from its rulemaking agenda⁸⁶—does not inspire confidence that providing detailed data demonstrating cost savings for investors is affecting SEC policymaking as it should.

⁸⁰ To be eligible for cross trading, a security must have a “readily available market quotation.” In the Fair Value Release, the SEC set forth a new definition of this term (which applies for purposes of both the fair value and cross trading rules). Few fixed-income securities have “readily available market quotations,” and therefore funds’ ability to cross trade these securities will be severely restricted as of September 8.

⁸¹ See Fair Value Release at 95 (“[C]onsideration of potential revisions to rule 17a-7 is on the rulemaking agenda. We welcome input from the public as we undertake our consideration of rule 17a-7.”); see also *Staff Statement on Investment Company Cross Trading*, SEC Division of Investment Management Staff (March 11, 2021), available at www.sec.gov/news/public-statement/investment-management-statement-investment-company-cross-trading-031121 (“In addition, as the Commission stated in adopting the Valuation Rule, consideration of potential amendments to rule 17a-7 is on the rulemaking agenda. ... We believe that funds’ cross trading practices have evolved over the last several decades and, accordingly, we believe it is once again appropriate to assess what, if any, changes to rule 17a-7 may be warranted.”).

⁸² See generally *Rule 17a-7 at the Crossroads: The Right Path Forward*, Investment Company Institute (April 2021) (providing results of an extensive member survey), available at www.sec.gov/file/investment-company-institute.pdf.

⁸³ Fifty-two ICI member firms responded, representing more than \$23 trillion, or approximately 71 percent of US-registered fund assets, as of December 31, 2020.

⁸⁴ *Falling Further Back—Statement on Chair Gensler’s Regulatory Agenda*, Commissioners Hester M. Pierce and Elad L. Roisman (Dec. 12, 2021), available at www.sec.gov/news/statement/peirce-roisman-falling-further-back-121321 (“the [SEC’s Rulemaking] Agenda abandons the much-needed effort to amend Investment Company Act Rule 17a-7... Commenters have been nearly unanimous in conveying the importance of funds’ ability to trade fixed-income securities across affiliated funds. Many commenters also have recommended conditions to ensure the protection of fund investors. ... Yet now, despite the demonstrated need for such amendments, the Agenda simply drops the planned rewrite of Rule 17a-7. As a consequence, we will not fix a problem of which we are aware—the impending inability of funds to cross-trade fixed-income securities—and we will miss a chance to modernize an outdated rule.”)

⁸⁵ *Rule 17a-7 at the Crossroads: Supplemental Information on Equity Cross Trading*, Investment Company Institute (October 2021), available at www.ici.org/system/files/2021-10/21_ppr_rule17a7_supplement.pdf.

⁸⁶ See *supra*, notes 4 and 48.

2.4 Comparing Index Providers to Subadvisers Is Inapt

A recent academic article suggested that there is a “reasonable argument” for treating index providers as subadvisers, and that a “regulatory gap” exists in the treatment of fund subadvisers and index providers.⁸⁷ We disagree. These roles differ substantially, and conflating them would serve no valid policy interest.

A subadviser has discretion to manage all or a portion of a fund’s assets, although it must do so strictly in accordance with its subadvisory agreement and the fund’s investment objective, strategies, and policies and applicable law and regulation. In the subadvisory context, portfolio management includes ongoing compliance monitoring, determining which brokers and dealers to use for executing fund trades, working with domestic and foreign custodians to open and maintain accounts, exercising rights incident to the fund’s portfolio securities, maintaining applicable records, and meeting with, and reporting to, the primary adviser and fund board as requested. A subadviser also may have proxy voting responsibility and may consult to varying degrees with the fund’s primary adviser on matters such as valuation and liquidity risk management. In sum, subadvisers manage fund assets and carry out several related responsibilities on their behalf, functions captured and contemplated by the Act’s definition.

Index providers do none of these things for funds. At core, index providers are entities that provide generalized information to advisers and others.

Thus, treating subadvisers and index providers differently under the Investment Company Act—as the fund industry and the SEC historically have done for decades—is entirely appropriate and results in no “regulatory gap.” Many entities provide data to fund advisers (or subadvisers) that impact how the fund is managed. By contrast, the fund’s adviser (or subadviser) has significant and express agency authority to act on the fund’s behalf, and assumes all related contractual, fiduciary, and regulatory obligations in connection with this work. It is on these entities—not information providers—where the Act’s adviser-related requirements properly belong.

3. ICI Recommends Amending the SEC’s Fund Disclosure Requirements Related to Indexes

While we strongly oppose treating index providers as investment advisers under the Investment Company Act, the SEC could take certain actions related to indexes for the benefit of funds and their investors. The release notes that three index providers accounted for over two-thirds of the market for indexes, totaling approximately \$5.0 billion in revenue in 2021.⁸⁸ A 2018 estimate of

⁸⁷ See Paul G. Mahoney & Adriana Z. Robertson, *Advisers by Another Name*, University of Virginia School of Law (Jan. 2021), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3767087 (“[C]ompiling an index... is an inherently discretionary exercise.”).

⁸⁸ Release at 6.

global revenues of the major industry players was \$3.5 billion,⁸⁹ so this revenue figure is large and growing—the article that the release cites states that over the past five years, the compound annual growth rate of these revenues averaged 11.7 percent.

Revenue for one is cost for another, and a significant portion of these revenues come from fund complexes. Indeed, our members have been long concerned about licensing practices and significant fee increases for critical data and information from providers that face minimal competition, such as the securities information processors (SIPs) that currently collect, distribute, and disseminate consolidated equity market data.⁹⁰ In preparing this comment letter, members have informed us that indexing fees have increased dramatically in recent years, including for actively-managed funds seeking to use index information in limited ways (e.g., as SEC-mandated performance benchmarks in prospectuses and shareholder reports); that index providers have become increasingly creative in how they charge their clients (e.g., bundling required services such as basic licensing rights with others that the clients may not want or use); and that index providers have become increasingly specific in how index information may be provided in funds' and advisers' materials. To the extent that data providers are integrated (e.g., where exchanges are affiliated with index providers), these issues may be compounded.⁹¹

We addressed this topic in our comment letter⁹² on the SEC's 2020 disclosure proposal for funds.⁹³ We noted generally that broader choice in a fund's index selection for regulatory purposes—including among affiliated indexes, if appropriate—would improve market dynamics. If nothing else, it would provide funds with a measure of control over costs, insofar as funds may be able to select from a wider array of indexes that may not require entering into new or

⁸⁹ *Opportunities and Risks in the Financial Index Market*, Autorite Des Marches Financiers, Laurent Grillet-Aubelt (June 2020) (“AMF Market Study”), at 53, available at www.amf-france.org/sites/default/files/2020-06/opportunities-and-risks-in-the-financial-index-markets.pdf.

⁹⁰ See, e.g., Letter from Dorothy Donohue, Deputy General Counsel, ICI, to Vanessa A. Countryman, Secretary, SEC, dated May 26, 2020, available at www.sec.gov/comments/s7-03-20/s70320-7246790-217250.pdf (supporting replacement of the exclusive SIP model with competing consolidators to enhance competition with respect to the dissemination of consolidated equity market data).

⁹¹ See, e.g., AMF Market Study at 49 (discussing the growing prevalence of financial ties between index administrators and stock exchanges as a major industry trend that illustrates the benefit of index administrators' privileged access to data).

⁹² See Letter from Susan Olson, General Counsel, and Dorothy Donohue, Deputy General Counsel, ICI, to Vanessa A. Countryman, Secretary, SEC, dated Dec. 21, 2020, at 21-27, available at www.sec.gov/comments/s7-09-20/s70920-8186011-227164.pdf.

⁹³ *Tailored Shareholder Reports, Treatment of Annual Prospectus Updates for Existing Investors, and Improved Fee and Risk Disclosure for Mutual Funds and Exchange-Traded Funds; Fee Information in Investment Company Advertisements*, SEC Release Nos. 33-10814; 34-89478; IC-33963 (Aug. 5, 2020), available at www.sec.gov/rules/proposed/2020/33-10814.pdf.

expanded licensing agreements with third parties. More specifically, we recommended that the SEC amend Forms N-1A and N-2 to:

- Require only that a fund compare its performance to an “appropriate” index and define that term (in relevant part) as follows: “An ‘appropriate index’ is one whose objective (*i.e.*, what it seeks to measure) is reasonably related to the Fund’s investment objective and principal investment strategies.”⁹⁴
- Provide an alternative to this general requirement, whereby a fund that determines that it does not have an appropriate index (as defined above) could select a cash-oriented benchmark and explain why it is appropriate, given the fund’s investment objective and strategies.
- Require that a fund using a blended benchmark (which may serve as an appropriate index) identify its underlying components and their weights.
- Correspondingly amend the definition of “additional indexes.”⁹⁵

Our recommended changes would eliminate the “broad-based” and “securities market” requirements and the affiliation restriction. The affiliation restriction would become especially problematic if index providers were deemed “investment advisers” under the Investment Company Act. The current Form instruction states that “an ‘appropriate broad-based securities market index’ is one that is administered by *an organization that is not an affiliated person of the Fund*, its investment adviser, or principal underwriter, unless the index is widely recognized and used.”⁹⁶ If index providers are deemed “investment advisers,” then they also would be index-based fund affiliates, and index-based funds would be precluded from using their tracking indexes as “appropriate broad-based securities market indexes” in their prospectuses and shareholder reports unless the indexes were “widely recognized and used.” If an index-based fund wished to track an index that was *not* “widely recognized and used,” then it would present the returns of *two* indexes in these regulatory documents at increased cost—showing the tracking index alone would no longer suffice. In this case, it would be impossible for an index-based fund to operate entirely without larger index providers. This result would only further entrench the large and well-established players, impair competition, and raise fund costs.

⁹⁴ *Cf.* Rule 18f-4(c)(2)(i) (“The fund must comply with the relative VaR test unless the derivatives risk manager reasonably determines that a designated reference portfolio would not provide an appropriate reference portfolio for purposes of the relative VaR test, taking into account the fund’s investments, investment objectives, and strategy.”).

⁹⁵ We recommend that it read: “A Fund may, but is not required, to compare its performance not only to the required appropriate index, but also to other appropriate indexes, so long as the comparison in each case is not misleading.”

⁹⁶ Emphasis added. Instruction 5 to Item 27(b)(7)(ii)(A) of Form N-1A.

Finally, we recommend that the SEC eliminate the requirement that a fund switching benchmark indexes show the performance of new and old indexes in its prospectus and shareholder report for one year.⁹⁷

Doing so can increase costs, if a fund complex must maintain agreements with two index providers beyond the point when it otherwise would do so. This possibility is not hypothetical. One member reported that it currently contracts with an index provider to permit it to use one index as a performance benchmark in its prospectus, shareholder report, and certain advertisements—the member requires no additional services. This index provider is now seeking to increase its fee *tenfold* as part of a multi-year contractual commitment. The member would like to sever ties with this index provider immediately and adopt a new performance benchmark offered by another index provider, but this SEC disclosure requirement could compel it to extend its relationship with this index provider and incur hundreds of thousands of unwanted, unnecessary, and duplicative costs. For a fund with approximately \$150 million in assets, this would have a meaningful and deleterious impact on its cost structure, one that smaller funds seeking to remain competitive can ill-afford.

This SEC disclosure requirement aids incumbent index providers but provides almost nothing in the way of investor protection. We support requiring a fund to explain the reason(s) for a change in indexes as the Form currently requires—this should suffice. If the SEC is concerned that a fund may switch to an index with worse historical performance to improve the fund's performance relative to the new benchmark, the SEC also could require a fund switching indexes to indicate whether the performance of the new index is materially worse than that of the former index (which, to avoid triggering continued licensing requirements, it need not name).

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⁹⁷ Instruction 2(c) to Item 4(b)(2)(iii) and Instruction 7 to Item 27(b)(7)(ii)(A) of Form N-1A.

Ms. Vanessa A. Countryman

August 16, 2022

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We appreciate your consideration of our comments. If you have any questions, please do not hesitate to contact Susan Olson at (202) 326-5813 or Matthew Thornton at (202) 371-5406.

Sincerely,

/s/ Susan Olson

/s/ Matthew Thornton

Susan Olson
General Counsel

Matthew Thornton
Associate General Counsel

cc: The Honorable Gary Gensler
The Honorable Hester M. Peirce
The Honorable Caroline A. Crenshaw
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