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October 10, 2022

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

Re: *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*

Dear Ms. Countryman:

The Investment Company Institute (ICI)[1] is writing to supplement our prior comments on the SEC's 2020 disclosure proposal for open-end funds ("funds").[2] Most recently, on September 15, the SEC's Office of the Investor Advocate filed with the Commission a research paper on funds' choice of performance benchmarks and related impacts on investor decision-making.[3] Our comments focus on that paper. While the research paper's survey results provide some useful insights, the limitations and methodological choices of the paper's analysis of funds' benchmark selections significantly undermine its value. We describe the paper's shortcomings below and urge the SEC to consider our comments alongside the research paper.

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[1] The Investment Company Institute (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 $28.8 trillion in the United States, serving more than 100 million investors, and an additional $8.1 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.

[2] *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) (the "proposal"), available at www.sec.gov/rules/proposed/2020/33-10814.pdf.

[3] *How do Consumers Understand Investment Quality? The Role of Performance Benchmarks*, SEC Office of the Investor Advocate (the "research paper"), available at www.sec.gov/comments/s7-09-20/s70920-20142980-308757.pdf.

The research paper's survey work confirms the importance of performance benchmarks to investors, which is consistent with our own survey work.[4] Indeed, we addressed this subject extensively in our 2020 comment letter on the proposal[5] and again in response to the SEC's request for comment on information providers[6] precisely because of the importance of performance benchmarks to investors.

However, the research paper also appears to support the proposal's policy preference to mandate that *all* funds use "broad-based" indexes as performance benchmarks,[7] yet that policy choice fails to appropriately take into account the diversity among the 11,394 long-term open-end funds.[8] If adopted as proposed, the SEC's changes to funds' performance benchmark requirements would provide funds with less discretion in choosing their broad-based benchmarks and, accordingly, investors with less relevant performance information.

Below, after summarizing the SEC's current and proposed performance disclosure requirements, we analyze the research paper's findings and methodologies. We find that:

- The paper contains some constructive findings. For instance, the underlying results do not find evidence that survey participants believed that the broad benchmark is a better reference point than the narrow benchmark.
- In the paper's attempt to "provide further descriptive evidence on the potential for strategic behavior by funds in benchmark disclosure" (Section 7), its reclassification of funds' *actual* primary and secondary benchmark determinations based on their correlations to the S&P 500 Index is a misguided methodological choice. This choice, in fact, obscures actual fund benchmark selection behavior and therefore provides an unreliable assessment of that behavior.

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[4] *See infra*, note 19.

[5] *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.

[6] *Request for Comment on Certain Information Providers Acting as Investment Advisers*, SEC Release Nos. IA–6050; IC-34618 (June 15, 2022) (the "RFC"), available at www.sec.gov/rules/other/2022/ia-6050.pdf. *See* Letter from Susan Olson, General Counsel, and Matthew Thornton, Associate General Counsel, ICI, to Vanessa Countryman, Secretary, SEC, dated August 16, 2022, at 28-31, at www.sec.gov/comments/s7-18-22/s71822-20136148-306949.pdf

[7] 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. An index may serve as a benchmark against which to evaluate a fund's investment performance.

[8] This figure is based on ICI data as of August 31, 2022. It consists of 8,517 mutual funds (the mutual fund figure excludes money market funds) and 2,877 ETFs.

- In any event, the evidence in Section 7 for any claim that broad (primary) benchmarks are superior to secondary benchmarks is weaker and more mixed than suggested by the paper's summary in Section 8. In key places, the econometric results in Section 7 argue *against* generalized claims of superiority of broad-based benchmarks, and against the notion that funds use secondary benchmarks strategically to boost their attractiveness to investors, as Section 8 suggests.

We also explain that:

- The research paper's focus on actively managed equity funds limits its usefulness when considering the broad array of fund types to which Form N-1A's requirements apply (e.g., index funds and funds of funds).
- In places, the paper appears to press for greater adoption of the S&P 500 Index as equity funds' primary benchmark, which would be bad policy (funds are too diverse in their investment portfolios and strategies for one or even several indexes to be universally appropriate) and economically problematic (*de facto* SEC endorsement of certain indexes would create market distortions and likely increase fund licensing costs).
- The research paper does not address the costs that funds incur in including index information in their prospectuses and shareholder reports, or how these costs might change if the SEC's requirements change.

Finally, on procedure, we generally have no objection to the SEC leaving this comment file open and taking public feedback for a reasonably practicable period. The recent flood of SEC rule proposals and their short comment periods make such an approach valuable in ensuring the Commission receives adequate public comment.[9] In this case, however, we have serious

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[9] 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.

concerns because it is the SEC staff adding to the comment file a mere month before the SEC's target completion date of October for this rulemaking.[10] If the SEC adopts rule and form amendments in October as planned, the public would have had little opportunity to comment on SEC staff work that could shape any final Commission actions.

In cases where SEC staff submit materials to an open comment file, the SEC should (i) proactively publicize the new material, and (ii) provide sufficient time for public responses to SEC staff work to inform the SEC's rulemaking process. In such circumstances, the Commission also should consider re-opening the comment period for the public.

1. Background on Performance Benchmark Requirements for Funds

Currently, a fund must compare its performance to that of an "appropriate broad-based securities market index" in its prospectus and annual shareholder report.[11] The proposal would add the following to this defined term:

> A "broad-based index" is an index that represents the overall applicable domestic or international equity or debt markets, as appropriate.

The proposal explains that "[w]hile indexes based on narrow segments of the market may be useful for comparison purposes, we believe that all funds should compare their performance to the overall market."[12]

In our 2020 comment letter,[13] we opposed this proposed change, identified other shortcomings with the Form's current performance comparison requirements, and recommended several changes to those requirements. More specifically, we stated that the definition of "appropriate broad-based securities market index"—in both its current form and as proposed to be amended—is unduly narrow; in some cases creates potentially confusing and misleading performance presentations; distorts competition in the index market; and may add unnecessary costs. We

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[10] The SEC's Spring 2022 regulatory agenda is available at www.reginfo.gov/public/do/eAgendaMain?operation=OPERATION_GET_AGENCY_RULE_LIST&currentPub=true&agencyCode=&showStage=active&agencyCd=3235&csrf_token=ABBAA84824C29E01B566B0472A6E99E59C730916821A1461 3C79DE7F48AC8EAEF4CA3A7C929E9B10E667F119BAA4958D5293.

[11] Items 4(b)(2)(iii) and 27(b)(7)(ii)(A) of Form N-1A. The Form defines "appropriate broad-based securities market index" in relevant part as "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." A fund also may compare its performance to one or more "additional indexes" in their prospectuses and shareholder reports. Instruction 6 to Item 27(b)(7) of Form N-1A states that these would be indexes other than the required broad-based index, and may include "other more narrowly based indexes that reflect the market sectors in which the Fund invests" or "an additional broad-based index, or … a non-securities index (*e.g.*, the Consumer Price Index), so long as the comparison is not misleading."

[12] Proposal at 98.

[13] *See supra*, note 5.

noted that the SEC requirement includes two terms that are at times in conflict—a "broad-based" index will not necessarily be an "appropriate" index in that it may not provide an apt performance comparison, particularly for funds with more narrow investment objectives and strategies (e.g., sector funds). Just as the required means of determining the athletic prowess of an Olympic sprinter should not be a comparison to a decathlete, a fund that is not seeking "broad-based" investment exposures should not be required to compare itself to a "broad-based" index.

And in our comment letter on the RFC,[14] which we incorporate herein by reference, we recommended 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.[15] We explained that this current requirement can increase costs, if a fund complex must maintain agreements with two index providers beyond the point when it otherwise would do so.

2. ICI's Assessment of the Research Paper

The research paper studies the impact of fund performance benchmarks on investor decision-making and potential for strategic behavior by firms in displaying benchmarks. It notes that funds have some discretion in choosing their benchmarks,[16] "presenting opportunity for strategic selection."[17] (By "strategic selection," the authors mean choosing a benchmark to influence investor evaluations (e.g., one that the fund outperforms).) The paper seeks to understand how funds employ benchmarks and how investors respond to the presentation of benchmarks.

We analyze the paper below.

2.1 Some of the Research Paper's Investor Survey Findings Are Constructive

The research paper includes some constructive findings. For example, the investor survey work suggests that "benchmark presentation is consequential for investment decisions,"[18] which is consistent with ICI's survey work. According to ICI's latest survey on the subject, when mutual

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[14] *See supra*, note 6.

[15] Instruction 2(c) to Item 4(b)(2)(iii) and Instruction 7 to Item 27(b)(7)(ii)(A) of Form N-1A. With respect to this switching requirement, 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 and boost its attractiveness to investors, 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).

[16] *See supra*, note 11.

[17] Research paper at 4.

[18] Research paper at 25.

fund–owning households were asked about the information they consider when choosing a mutual fund, 87 percent indicated that they considered a fund's performance compared with an index, and 39 percent saying this benchmarking was very important when making their purchase decision.[19]

The research paper also finds considerable support from survey participants for narrow benchmarks. The paper's survey work distinguishes between broad and narrow benchmarks to help determine how graphical presentations including these index types might affect how surveyed investors and non-investors would view the attractiveness of a hypothetical fund and make hypothetical investment allocation decisions. The proposal's (and the authors') strong preference for the primacy of "broad-based indexes" (a term that the proposal interprets narrowly) is not shared by survey participants, as demonstrated by the paper's quotes below:

- "there is little evidence that participants responded differently to the hypothetical broad and narrow … benchmarks we constructed."[20]
- "there is little evidence that participants … varied systematically in their evaluations for broad and narrow benchmarks although retirement-only investors differentiated within the two benchmark condition based on whether the narrow benchmark was above or below the fund."[21]
- "Regardless of investor status, participants overwhelmingly expressed a preference for a graph with both narrow and broad benchmarks."[22] In this regard we also would point out that all three investor types found the narrow and broad indexes to be similarly useful.[23]

2.2 The Research Paper's Analysis of Funds' Benchmark Performance Data Is Deeply Problematic

In Section 7, the research paper analyzes reclassified Morningstar data "to provide further descriptive evidence on the potential for strategic behavior by funds in benchmark disclosure."[24] It seeks to determine whether benchmark "fit" varies with funds' choices of benchmarks and also

[19] Holden, Sarah, Michael Bogdan, and Daniel Schrass. 2022. "What US Households Consider When They Select Mutual Funds, 2021." *ICI Research Perspective* 28, no. 3 (April), available at https://www.ici.org/system/files/2022-04/per28-03.pdf.

[20] Research paper at 25. Participants included non-investors, retirement-only investors, and independent investors.

[21] *Id*. at 28.

[22] *Id*. at 34.

[23] *Id*. at Figure 10, "Usefulness of comparisons" frame.

[24] *Id*. at 9.

compares the investment performance of funds to their primary and secondary benchmarks (as applicable) across 12 asset class categories.[25]

2.2.1 The Paper's Reclassification of Funds' Actual Benchmark Selections Is Methodologically Unsound

Crucially, the findings of this section are called into question because of a key and flawed methodological choice that the research paper makes. The method begins by referencing funds' primary and secondary benchmarks, in Morningstar data collected from each fund's prospectus. The method next reclassifies benchmarks as "primary" and "secondary" based on their correlations to the S&P 500 Index (i.e., the fund benchmark with the highest correlation was (re)labeled as the fund's primary benchmark).[26] These reclassifications confound and obscure funds' actual selections of their primary and secondary benchmarks using a method (correlation to the S&P 500 Index) with no connection to the Form's requirements or appreciation of funds' diverse investment portfolios and strategies.

The reason given for this reclassification—that "there is no ordering requirement for fund benchmarks, [and therefore] Morningstar's identification of primary and secondary benchmarks could provide an imperfect mapping to 'broad' and 'narrow' indexes as described in regulatory requirements"[27]—is not well-founded.

First, as a legal matter, a fund's classification of its primary (or "broad-based") and secondary (or "additional") indexes[28] is identifiable. While Form N-1A may not have an ordering requirement, it requires a fund to use a broad-based securities market index and, if the fund uses an additional index, the fund must "disclose information about the additional index in the narrative explanation accompanying the bar chart and table (e.g., by stating that the information shows how the Fund's performance compares with the returns of an index of funds with similar investment objectives)."[29] A similar requirement does not apply to a fund's "broad-based securities market index," so the two index types are distinguishable in this way (i.e., an index without accompanying narrative disclosure is a "broad-based securities market index"). Morningstar's classifications of funds' benchmarks as "primary" and "secondary" are based on information obtained directly from fund prospectuses—a sound methodological approach. The paper should

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[25] The categories are Large Growth, Large Blend, Large Value, Divers. Emer. Mrkts, Fn. Large Blend (we assume "Fn." is "Foreign"), Small Growth, Mid-Cap Growth, Small Value, Fn. Large Growth, Mid-Cap Value, and Mid-Cap Blend.

[26] *Id*. at 10 and 44.

[27] *Id*. at 10.

[28] *See infra*, note 48 and accompanying text.

[29] Instruction 2(b) to Item 4(b)(2)(iii) of Form N-1A.

not have deviated from a data source that captures funds' *actual* primary/secondary index classifications.

Nor is there good reason to override funds' actual primary/secondary index classifications based on correlations to the S&P 500 Index. This choice is neither quantitatively nor qualitatively sound. Earlier, the research paper documents that the S&P 500 Total Return Index accounts for 23 percent of the primary benchmarks presented in the research paper.[30] This index describes itself as a "gauge of large-cap U.S. equities,"[31] and nine of the 12 categories in Table 8 are asset classes other than US large cap equities. As discussed further below, assuming that the S&P 500 Index is the "right" index for *all* actively managed equity funds and equity indexes is flawed, given the diversity of exposures and strategies represented in the paper's 3,000+ equity fund sample.

Finally, the paper's methodology may result in cases where it overrides a fund's benchmark decisions and relabels as "primary" an index that is less broad and less appropriate than what the fund has selected for itself. To illustrate, suppose a global equity fund has a global equity index as its primary index and the S&P 500 Index as its secondary index. The paper's methodology would reassign to the fund as its primary index (the S&P 500 Index) one that is narrower and less appropriate, demonstrating another conceptual problem with this reclassification method.

In sum, the research paper's methods obfuscate, and to some degree misrepresent, funds' actual choices. This is particularly concerning when the purpose of the exercise is to assess whether funds engage in "strategic" benchmark selection.

2.2.2 Section 7's Findings Are Weak, and Section 8's Summary of Those Findings Is Overstated

Leaving these concerns aside and taking Table 8 (in Section 7) of the research paper at face value, the conclusions that the research paper draws from it are vastly overstated. With respect to benchmark "fit" (estimated by way of average R-squared), Table 8 first broadly shows that secondary benchmark fit is better than primary benchmark fit for most of the asset class categories. In only three of 12 cases is the primary benchmark a better fit. Also, the paper does not consider that these are actively managed equity funds, so we would not expect them to demonstrate perfect (or in some cases, even high) fit with either index. Moreover, a strong policy preference for funds' required use of "broad-based" benchmarks, especially if such indexes must reflect "the overall market,"[32] would likely *reduce* the fit of primary benchmarks to funds in the

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[30] Research paper at 10.

[31] *See* S&P Dow Jones Indices S&P 500 Fact Sheet (August 31, 2022).

[32] Proposal at 98.

aggregate, particularly for funds that do not have broad-based investment objectives and strategies.

When moving from "fit" to considering relative investment performance of primary and secondary benchmarks—again, these data do not accurately capture funds' actual selections—several growth asset classes and the emerging markets asset class further show the secondary benchmarks *outperformed* the primary benchmarks. For only one of the 12 asset classes does the primary benchmark outperform 100 percent of the time. For another asset class, the primary benchmark outperformed 50 percent of the time, making any rule that might favor "broad" or "narrow" benchmarks entirely arbitrary. In the 10 other cases, the results are a mixed bag, underscoring the importance of affording funds the choice of index that is most appropriate.[33]

Table 8 also offers considerable evidence that funds do *not* strategically select secondary benchmarks with relatively weak performance to improve the funds' attractiveness to investors. Here, most funds do not use a secondary benchmark—roughly 30 percent do so.[34] For the roughly 30 percent of funds using secondary benchmarks, Table 8 shows very small percentages of observations that are consistent with an opportunistic "sandwich" benchmarking hypothesis (i.e., where the performance of the primary benchmark is highest, followed by the fund, and then the secondary benchmark). Across all 12 categories, it appears that about 96 percent of funds with secondary benchmarks do not evidence potentially strategic benchmarking.[35] Overall, only about 1 percent of the total sample displays evidence consistent with the "sandwich case" hypothesis.[36]

Yet on this key point the research paper concludes: "The sandwich case positioning of benchmarks and funds in our experimental conditions may appear a special situation, but in reality, the experimental conditions we created represent a large fraction of presentation conditions experienced in the wild."[37] The research paper then states, "In each of the 12 sectors

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[33] For example, for the diversified emerging markets fund category, the labeled secondary indexes outperformed the labeled primary indexes 77 percent of the time, suggesting a rule requiring either of the benchmarks to be primary would fail to allow for the use of a better-performing benchmark either 23 percent or 77 percent of the time.

[34] Research paper at 10.

[35] Unfortunately, the research paper does not report fund counts in Table 8, so these estimates are based on simple averages across the 12 categories. It is important to consider both types of "sandwiching" cases (i.e., including those where the performance of the secondary benchmark is highest, followed by the fund, and then the primary benchmark), especially given the relabeling of "primary" benchmarks based on proximate correlation to the S&P 500 Index. Averaging across all styles of funds with two benchmarks, about 3 percent of this sample have a fund between a higher performing primary benchmark and a weaker performing secondary benchmark, and about 1 percent are represented by a higher performing secondary benchmark and a weaker performing primary benchmark. Thus, 4 percent of funds with two benchmarks are characterized as having sandwiched benchmark performance.

[36] Because only 30 percent of funds have two benchmarks, this 4 percent characterized by sandwich benchmarking performance only amounts to about 1 percent of the total sample.

[37] Research paper at 44.

we studied, our presentation cases represented as few as 60 percent of funds in the sector and as many of [*sic*] 76 percent of funds in the sector."[38] While the paper is not entirely clear, the numbers quoted in this sentence appear to be the low and high figures when summing the final four rows for each of the 12 asset class categories. If this is correct, these numbers have nothing to do with the percentages of sandwich cases, let alone *strategic* sandwich cases. At best, the sentence confusingly jumps to an unrelated idea; at worst, if read as support for their concern over sandwich benchmarking, it is deeply misleading.

In short, notwithstanding our serious questions about why the research paper chose to reclassify the funds' own benchmark choices, the results taken as a whole are overstated in Section 8 and do not support prescriptive regulation in this area.

2.3 The Research Paper Has Other Limitations and Shortcomings

In addition to the concerns expressed above on Sections 7 and 8, we have additional concerns about the limitations of the research paper and certain of its implicit policy judgments.

First, the research paper concentrates on actively managed equity funds and excludes index funds and target date funds. While perhaps understandable, these fund types hold trillions in assets, and the current and proposed Form requirements are not well-suited to them. Requiring an index fund that seeks to track a narrow index to compare itself to a different broad-based index raises several concerns, including investor confusion. Also, Form N-1A disfavors affiliated indexes (in most cases the Form would preclude a fund seeking to track an affiliated index from comparing itself only to that index).[39] These requirements can lead to inapt comparisons for index funds.

We note that the current Form requirements also produce potentially unwieldy and confusing performance presentations for multi-asset funds of funds (e.g., target date funds). As we explained in our 2020 comment letter, the difficulty for these funds is that *no* single widely used index may be sufficiently appropriate or broad.[40] A broad-based equity or bond index very well may meet the SEC's definition and yet still provide an inapt comparison for a target date fund due to the greater breadth of the fund's investment exposures. To remedy this, a target date fund may include more indexes in its performance presentations, which may confuse investors. While the survey work in the research paper generally shows that the participants were comfortable with graphical performance presentations that included two benchmarks, it is not at all clear that this would continue to hold if presentations included more than two. We therefore stress that

[38] *Id*.

[39] *See supra*, note 11.

[40] For instance, it is not uncommon for a target date fund to compare its performance to one or more equity indexes, one or more bond indexes, and finally a "blended" index. A blended index is one that combines the performance of multiple indexes, weighted based on the fund's approximate asset allocation.

funds (particularly those with exposure to multiple asset classes) should be permitted to use blended indexes as their sole benchmarks, provided they identify their underlying components and associated weights.

Second, in places the research paper appears to press for greater adoption (and therefore licensing) of the S&P 500 Index as an (or perhaps *the*) appropriate index for equity funds to use for performance comparisons. For instance, Section 2.1 explores the correlations between the S&P 500 Index with other indexes that funds use. It notes that the MSCI ACWI Index has a correlation of 0.96. It concludes that "in our data, only about half of funds present at least one benchmark that has a correlation with the S&P 500 Index of 0.95 or above."[41]

But this is neither unusual nor inappropriate. The 3,187 actively managed equity funds in the research paper's sample are diverse in their geographic exposures (e.g., US, regional, ex-US country-specific, etc.), security type (e.g., large-cap, mid-cap, small-cap, etc.), sector exposures (e.g., technology, energy, health care, consumer stables, etc.), and styles (e.g., growth, value, quantitative, etc.). We would expect their chosen benchmarks—whether "broad-based" or "additional"—to exhibit similar diversity. Consequently, we firmly reject any notion that a single equity index should be presumptively preferred across all equity funds, or that correlation of an index's returns to those of the S&P 500 Index is the proper test for determining whether a fund's chosen "appropriate broad-based securities market index" satisfies the "appropriateness" part of the definition.

We also would note that the comparison to the MSCI ACWI is less illuminating than it may appear. As of August 31, 2022, this index's US weighting was nearly 62 percent. Its top five constituents were names familiar to US investors: Apple (4.49 percent), Microsoft (3.26 percent), Amazon (2.03 percent), Tesla (1.27 percent), and Alphabet A (1.14 percent).[42] As of that same date, the S&P 500 Index had the same top five.[43] It is not at all surprising that such an index would be highly correlated to the S&P 500 Index. The choice of a global index that includes US equities is more likely to show a high correlation to the S&P 500 Index than the choice of an international "ex-US" index would have been. For instance, an Asian equity index would have weaker correlation to the S&P 500 Index, and there should be no suggestion that somehow an Asian equity fund ought to use the S&P 500 Index (or the MSCI ACWI, for that matter).

In a similar vein, the research paper notes, "Some funds use extremely rare benchmarks (4.5%). Within the 12 sectors we reviewed, each sector tended to have between 2 and 13 benchmarks

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[41] Research paper at 12.

[42] See MSCI ACWI Index (USD) Fact Sheet (August 31, 2022), available at www.msci.com/documents/10199/a71b65b5-d0ea-4b5c-a709-24b1213bc3c5.

[43] *See supra*, note 31.

used by only one fund."[44] We fail to see the issue with a diverse 3,000+ sample of actively managed equity funds using a variety of indexes, given that there are about 2.3 million available equity indexes.[45]

The SEC should not be picking winners in this space by pressing funds to use *de facto* "approved" indexes. As we have noted, index construction and administration often involve a significant number of assumptions, inputs, rules, and methodological choices. No single way exists to measure the performance of, or even define, a "market."[46] Therefore, there is no objectively "correct" index. Economically, regulatory favoritism risks distorting market dynamics, entrenching incumbents, and increasing fund costs. The SEC's focus should be in ensuring that funds' chosen benchmarks for investors are appropriate, as we have proposed defining this term.[47] Yet the proposal and this research paper lean in a more uniform and prescriptive direction, in spite of the paper's actual results.

Third, the interchangeable use of the terms "narrow" and "secondary" throughout the research paper is imprecise and overly reductive.[48] Form N-1A permits funds to include "additional indexes," which may or may not be narrow.[49] Additionally, Form N-1A requires an open-end fund to compare its performance to an appropriate broad-based securities market index in its prospectus. Because of this conflation, it is difficult to disentangle the paper's findings and their potential policy implications.

Finally, the research paper does not address the costs that funds incur in including index information in their prospectuses and shareholder reports. To the extent that Form amendments

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[44] Research paper at 41.

[45] *See* Press Release for the Index Industry Association's Fifth Annual Benchmark Survey Shows Record Growth in Number of ESG Indices, Alongside Broadening of Fixed Income Indices (October 25, 2021), available at https://www.indexindustry.org/fifth-annual-benchmark-survey-shows-record-growth-in-number-of-esg-indices-alongside-broadening-of-fixed-income-indices-2/ (noting that members administer more than 3 million indices, and equities comprise 76% of indices).

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

[47] In our 2020 comment letter, 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." Under this definition, funds would have flexibility to make this "appropriateness" determination, and SEC staff reviews of these fund determinations would be for general reasonableness.

[48] While the paper's use of the terms "primary" and "secondary" are not technically correct, we do not find those terms objectionable because they are more consistent with Form N-1A's defined terms (i.e., "appropriate broad-based securities market index" and "additional index") and overall policy thrust.

[49] *See supra*, note 11.

reduce funds' flexibility in choosing indexes, funds will have less control over costs and further entrench and empower today's largest index providers.

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We appreciate your consideration of our comments. If you have any questions, please do not hesitate to contact Jason Seligman at (202) 326-5866 or Matthew Thornton at (202) 371-5406.

Sincerely,

/s/ Jason Seligman	/s/ Matthew Thornton
Jason Seligman Senior Economist	Matthew Thornton Associate General Counsel

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