August 15, 2022

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

VIA ELECTRONIC MAIL: rule-comments@sec.gov

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

Dear Ms. Countryman:

The Committee on Capital Markets Regulation (the "**Committee**") is grateful to the Securities and Exchange Commission (the "**SEC**") for the opportunity to respond to the SEC's "Request for Comment on Certain Information Providers Acting As Investment Advisers" (the "**Request for Comment**").[1]

Founded in 2006, the Committee is dedicated to enhancing the competitiveness of U.S. capital markets and ensuring the stability of the U.S. financial system. Our membership includes thirty-seven leaders drawn from the finance, investment, business, law, accounting, and academic communities. The Committee is chaired jointly by R. Glenn Hubbard (Emeritus Dean, Columbia Business School) and John L. Thornton (Former Chairman, The Brookings Institution) and is led by Hal S. Scott (Emeritus Nomura Professor of International Financial Systems at Harvard Law School and President of the Program on International Financial Systems). The Committee is an independent and nonpartisan 501(c)(3) research organization, financed by contributions from individuals, foundations, and corporations.

The Request for Comment seeks input on the extent to which financial index providers, model portfolio providers, and pricing services (together, "**information providers**") are or should be regulated as "investment advisers" under the Investment Advisers Act of 1940 (the "**Advisers Act**") or the Investment Company Act of 1940 (the "**Company Act**"), including the costs and benefits of regulating them as such. In this letter, the Committee focuses on the providers of financial indices ("**index providers**"). Part I of this letter reviews the operation of index providers and their role in the investment process. Part I also identifies important distinctions between index providers and investment advisers. Part II reviews the legal issue as to whether index providers are "investment advisers" under the Advisers Act or Company Act and concludes that they are not. Part III argues that regulation of index providers as investment advisers is unnecessary and undesirable from a policy perspective.

[1] 17 CFR Part 270 and 275 [Release Nos. IA-6050; IC-34618; File No. S7-18-22] RIN 3235-AM95 [the "**Request for Comment**"].

Part I: The function and operation of index providers is distinct from that of investment advisers.

A financial index is a basket of securities, derivatives, or other financial instruments that represents and measures the performance of a market, asset class, or investment strategy.[2] For example, a stock index measures the combined performance of a group of equity securities. The S&P 500, published by S&P Dow Jones Indices ("**S&P**"), is one such index. It consists of five hundred large cap companies listed on U.S. stock exchanges, weighted by float-adjusted market capitalization.[3]

Index providers determine which securities to include in an index and how to weight them based on rules that the index provider develops and publishes in a methodology statement.[4] Index providers publish the value of an index on a frequent and standardized basis, typically daily and sometimes in real time.[5]

Index providers license the use of their indices for a fee to their users, including investment advisers that manage investment funds.[6] These advisers then typically either (1) cause their funds to buy and sell securities such that the fund's assets track the performance of the index, in the case of passively managed "index" funds, or (2) use the index as a benchmark against which to compare the fund's performance, in the case of some actively managed funds.[7] Licensing fees that a public investment company pays to the index provider are economically borne by the fund's investors as part of a fund's expense ratio.[8]

Assets under management by index funds has been substantial and growing for decades. At year-end 2021, U.S. index mutual funds and index ETFs had approximately $5.7 trillion and $6.8 trillion in assets under management, respectively, for a total of $12.5 trillion.[9] U.S. index mutual funds' assets under management grew from $4.8 trillion at year-end 2020 and $1 trillion at year-end 2010.[10] The three largest index providers by revenue — FTSE Russell, MSCI, and S&P — are not affiliated with investment advisers to index funds and do not manage assets of their own.[11]

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[2] *See* S&P DOW JONES INDICES, *What is an index?* (May 2022), https://www.spglobal.com/spdji/en/research-insights/index-literacy/what-is-an-index/. "Float-adjustment" refers to the adjustment of each company's shares outstanding for long-term, strategic shareholders. *See* S&P DOW JONES INDICES, S&P Float Adjustment Methodology (Mar. 2022), https://www.spglobal.com/spdji/en/documents/index-policies/methodology-sp-float-adjustment.pdf.

[3] S&P DOW JONES INDICES, S&P500, https://www.spglobal.com/spdji/en/indices/equity/sp-500/#overview (last visited Jun. 23, 2022).

[4] *See* INVESTMENT COMPANY INSTITUTE, *Indexes and How Funds and Advisers Use Them: A Primer*, 1 (Jan. 2021), https://www.ici.org/system/files/attachments/pdf/21_ppr_index_primer.pdf.

[5] For overview of publishing process see, e.g., S&P Dow Jones Indices, *Who's Behind the Index,* https://www.spglobal.com/spdji/en/research-insights/index-literacy/who-s-behind-the-index/.

[6] *See*, *e.g.*, S&P Dow Jones, *Data & Index Licensing* (May 2022), https://www.spglobal.com/spdji/en/about-us/data-index-licensing.

[7] See SEC, *Index Funds*, https://www.investor.gov/introduction-investing/investing-basics/investment-products/mutual-funds-and-exchange-traded-4.

[8] See Form N-1A, Item 3. *See also* Paul Mahoney & Adriana Robertson, *Advisers by Another Name*, UNIVERSITY OF VIRGINIA SCHOOL OF LAW, LAW AND ECONOMICS PAPER SERIES 2021-01, 8 (Jan. 2021), https://corpgov.law.harvard.edu/2021/02/15/advisers-by-another-name/.

[9] *See* INVESTMENT COMPANY INSTITUTE, *2022 Investment Company Fact Book*, 29 (2022), https://www.icifactbook.org/pdf/2022_factbook_ch2.pdf

[10] *See id.* at Table 42, https://www.icifactbook.org/pdf/22-fb-table42.pdf.

[11] *See* INVESTMENT COMPANY INSTITUTE, *Indexes and How Funds and Advisers Use Them: A Primer*, 1 (Jan. 2021), https://www.ici.org/system/files/attachments/pdf/21_ppr_index_primer.pdf. *See also* Yu An, Matteo Benetton, Yang Song, *Index Providers: Whales Behind the Scenes of ETFs,* NEW YORK UNIVERSITY SCHOOL OF LAW, 12 (Jan. 12, 2022), https://www.law.nyu.edu/sites/default/files/Matteo%20Benetton%20Paper%20Final.pdf; Jackie Noblett, *Index providers' revenues jump to a record $4.1bn in 2020*, FINANCIAL TIMES (May 27, 2021).

An index provider typically develops and offers an index for license to the market based on a demand from market participants to measure a sector of financial markets, not a view that the constituent securities are good investments. Because an index is fundamentally a descriptive formula, market participants cannot invest directly in an index. Instead, market participants seeking to track the index invest either in the constituent securities or in instruments that bear a relationship to those assets (e.g., forward contracts, derivatives, ETFs etc.). The design and execution of an index-tracking strategy or measurement of a fund's performance relative to an index, as applicable, and the decision to begin, continue, or cease use of a selected index as an investment tool, are the responsibility of the user of the index, not the index provider.[12] Indeed, as discussed further below, the same index may simultaneously be used both by an investor who believes the index will appreciate and another who believes the index will depreciate.

In the U.S., investors may seek exposure to a market by investing in the shares of a registered investment company that tracks a relevant index for that market. The investment company tracks the index by investing in the assets constituting the index in the correct weighting and adjusting the weighting of the assets as the weighting of the index constituents changes.

The Request for Comment seeks input on the extent to which its descriptions of information providers, including index providers, are comprehensive and accurate.[13] The following subsections review the principal features of the methodologies, transparency practices, and governance mechanisms of major index providers in greater detail. Though we find that the Request for Comment's description is generally consistent with our own, we supplement the Request for Comment's description by highlighting important distinctions between index providers and investment advisers.

i) Methodology

Index providers select which securities to include in an index based on core criteria (e.g., company size, industry, or geography) and ancillary criteria (e.g., liquidity, public float, and trading history) defined in the index's methodology (e.g., to reflect the performance of the asset class that it seeks to measure).[14] Index providers assign weights to each security based on the published methodology. For example, indices may be market cap-weighted, price-weighted or equally weighted, among many other weighting methodologies (e.g., dividend yield). In a market cap-weighted index a constituent issuer's representation in the index is determined by the total value of its outstanding shares[15], whereas in a price-weighted index, its representation is determined by the price of one of its shares.[16] For example, the S&P 500 is a market-weighted index,[17] whereas the Dow Jones Industrial Average is a price-weighted index.[18] Based on its selection criteria and

[12] *See, e.g.*, Index License Agreement for Funds, dated March 18, 2000, by and between MSCI and Barclays, https://www.sec.gov/Archives/edgar/data/0001408198/000156459021005811/msci-ex101_172.htm.

[13] Request for Comment at 15.

[14] *See, e.g.*, Mayer Brown LLP, *Indices: The Good, the Bad and Knowing the Difference* (2019), https://www.mayerbrown.com/-/media/files/perspectives-events/publications/2019/02/white-paper-converted.pdf

[15] *See* FTSE RUSSELL, *How are indexes weighted?* https://www.ftserussell.com/education-center/how-are-indexes-weighted (last visited Jun. 30, 2022).

[16] *See* NASDAQ, *Price-weighted index* https://www.nasdaq.com/glossary/p/price-weighted-index (last visited Jun. 30, 2022).

[17] *See* S&P DOW JONES INDICES, S&P U.S. INDICES METHODOLOGY 3 (2022) https://www.spglobal.com/spdji/en/documents/methodologies/methodology-sp-us-indices.pdf.

[18] *See* S&P DOW JONES INDICES, DOW JONES AVERAGES METHODOLOGY 3 https://www.spglobal.com/spdji/en/documents/methodologies/methodology-dj-averages.pdf.

weighting methodology, the index provider periodically updates the constituent securities in the index, often quarterly.[19]

A financial index is thus a mathematical formula that describes, but does not anticipate, the performance of a set of financial instruments. It contains no information on the expected value of one or more instruments or the advisability of any investment strategy or asset allocation. For example, the S&P 500 methodology does not provide for modification of its contents if measures of the fundamental value of the constituent securities indicate that the index as composed is expected to decline.

ii) Transparency

To serve as a reliable benchmark and a useful investment tool, the contents and methodology of an index must be transparent.[20] Index providers therefore voluntarily disclose detailed information on their indices to the public, including the criteria for constituent eligibility, inclusion, and weighting, the criteria for recalibration of constituents and weights, and the processes for applying and changing the methodology.[21]

The development and offering of a financial index are thus distinct from the development and offering of an investment strategy. Whereas the utility of a financial index depends on its methodology being transparent to its users, the utility of an active investment strategy often depends on its opacity, since the success of the strategy may depend on details of its operation remaining confidential and irreplicable by other market participants. However, when an investment adviser chooses to track a transparent index or use it as a benchmark, how it uses the index and what it discloses about its strategy are determined by the adviser in compliance with the Advisers Act and the Company Act.

iii) Governance

To ensure the integrity and quality of indices, index providers also employ extensive governance and control frameworks, including by[22] (1) establishing "index committees" that oversee index design and maintenance,[23] (2) separating different operational functions (such as a credit rating business) from their indexing business to ensure independence,[24] (3) adopting policies and procedures for identifying and managing conflicts of interest,[25] and (4) seeking feedback on proposed index methodology changes by soliciting comments from market participants (e.g.,

[19] *See, e.g.*, BlackRock, *Equity Index Rebalances*, https://www.blackrock.com/au/intermediaries/ishares/equity-index-rebalances

[20] *See* S&P Dow Jones, *Methodology Matters*, https://www.spglobal.com/spdji/en/research-insights/index-literacy/methodology-matters/.

[21] *See* **ANNEX A** for a sample of the published index methodologies of some of the largest index providers.

[22] *See, e.g.*, S&P DOW JONES, *Governance* (May 2022), https://www.spglobal.com/spdji/en/governance/; MSCI, Corporate *Governance* (May 2022), https://ir.msci.com/corporate-governance; FTSE RUSSELL, *Governance Framework* (May 2022), https://research.ftserussell.com/products/downloads/FTSE_Russell_Governance_Framework.pdf.

[23] *See, e.g.*, S&P DOW JONES, *Equity Indices Policies & Practices Methodology* at 42 (May 2022), https://www.spglobal.com/spdji/en/documents/methodologies/methodology-sp-equity-indices-policies-practices.pdf.

[24] *See, e.g.*, S&P DOW JONES, *Legal Disclaimers* (May 2022), https://www.spglobal.com/spdji/en/disclaimers/; S&P DOW JONES INDICES, *Management Statement of Adherence with the IOSCO Principles for Financial Benchmarks, For the period June 1, 2020 through May 31, 2021*, 12 (accessed May 2022), https://www.spglobal.com/spdji/en/documents/legal/spdji-iosco-report-2021.pdf

[25] *See, e.g.*, FTSE RUSSELL, *Benchmark Administration: Governance and Conflicts of Interest Management* (May 2022),https://research.ftserussell.com/products/downloads/Benchmark_Administration_Governance_and_Conflicts_of_Interest_Management.pdf.

S&P's consultation process).[26] Moreover, the major index providers voluntarily comply with external guidelines, most prominently the IOSCO Principles, as discussed further in Part III.

iv) Responsibilities of the investment adviser.

The advisers to the registered investment companies that track indices are regulated as "investment advisers" under the Advisers Act and the Company Act and are thus required to register with the SEC and meet extensive regulatory requirements, including acting as a fiduciary to their clients, providing public disclosures concerning business practices, affiliates, fees and conflicts of interest, and undergoing compliance examinations by the SEC.[27] The funds themselves are regulated as "investment companies" under the Company Act.[28] Under the applicable rules, index funds must register with the SEC and disclose, among other things, the fund's investment objectives and strategy; fees and expenses (including license fees paid to index providers); principal risks; details about the fund manager; and the fund's procedures to address conflicts of interest.[29]

The investment adviser to such a company and the company's board are responsible, to the exclusion of the index provider, for the selection and use by the company of an index, including by researching potential indices and evaluating whether an index serves the fund's investment objective, and the design and execution of the company's index investing strategy. The adviser may choose to invest in all or less than all the securities in the index or may choose to use more than one index. The adviser and board are also responsible for providing adequate disclosure to fund investors in respect of the company's use of one or more indices. If the adviser requests that an index provider design a new index or modify an existing index to meet certain specifications, the adviser and board continue to bear responsibility for determining that the new or modified index serves the interests of the fund and its investors and evaluating whether the index provider has adequately carried out the adviser's request.

Part II: Index providers are not "investment advisers" under the Advisers Act or Company Act.

The Advisers Act requires certain individuals and entities that receive compensation for advising others about securities investments – that is, "investment advisers" – to "register with the SEC and conform to regulations designed to protect investors."[30] The Company Act regulates the conduct of investment advisers to publicly offered investment companies, for example by imposing "prohibitions related to self-dealing" among other things.[31] As the Request for Comment notes, index providers have not been regulated as "investment advisers" under the Advisers Act and Company Act.[32] Although the courts have not ruled on this issue, the SEC has not to date contested the position that an index provider is not an investment adviser under the Advisers Act or Company Act.[33] However, the Request for Comment seeks input on how information providers "analyze

[26] *See, e.g.*, S&P Dow Jones, *Consultations*, https://www.spglobal.com/spdji/en/governance/consultations; MSCI, *Index Consultations*, https://www.msci.com/index-consultations; FTSE Russell, *Market Consultations*, https://www.ftserussell.com/governance/market-consultations.

[27] *See generally* STAFF OF THE INVESTMENT ADVISER REGULATION OFFICE OF THE SEC, *Regulation of Investment Advisers by the SEC* (March 2013), https://www.sec.gov/about/offices/oia/oia_investman/rplaze-042012.pdf.

[28] 15 U.S.C. § 80a–3(a).

[29] *See, e.g.*, Form N-1A, Items 2, 3, 4, 5, 9, 10, 16, 17.

[30] https://www.sec.gov/investment/laws-and-rules.

[31] Request for Comment at 28.

[32] *Id*. at 15.

[33] *See* Mahoney & Robertson, *supra* note 8, at 34-36.

whether they meet the Advisers Act's definition of 'investment adviser' . . . ."[34] In this section we examine the basis for the position that index providers do not meet this definition, and conclude that it is well founded in existing law.

i) The Advisers Act

The Advisers Act defines "investment adviser" as "any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities[.]"[35]

Notwithstanding the breadth of the interpretation of the term in certain SEC guidance,[36] index providers are clearly distinguishable from the definition of "investment adviser." The role of the index provider is to create and maintain indices with predefined, transparent, and objective rules concerning company characteristics such as size, industry, geography, liquidity, public float, and trading history.[37] Neither the index provider nor the index itself expresses an opinion or view as to whether the assets composing the index will appreciate or depreciate, or recommends or promotes asset allocations, investments, or investment strategies. It is the responsibility of the index user, not the index provider, to define the role of the index in the user's investment strategy. Market participants also use indices in very different ways. Whereas those who believe that the index will increase may seek long exposure to the assets composing the index, those who take the opposite view may take short positions in the same assets. Some may employ the index as part of a broader asset allocation or investment strategy or otherwise combine assets that compose the index with other instruments to create unique investment positions. Moreover, different users may gain exposure to the same index in different ways: some may do so by purchasing the securities listed in the index or a subset thereof, whereas some may do so using derivative instruments such as futures or forward contracts. Active funds may use an index only as a benchmark to measure their own performance and thus may not invest in any of the assets composing the index, or a limited subset thereof.[38]

In our view the creation and application of rules to generate market data that different market participants use in different ways to pursue different investment strategies is distinct from "advising others" on the *value* of given securities or the *advisability* of purchasing or selling them or "analyzing" the *merits* of constituent securities. Though the process of compiling an index may involve consideration of the common aspects of certain sets of securities (e.g., market cap, geographical location), to the extent such activities could be viewed as "analysis," the analysis does not relate to the merits of investing in those securities. Index providers license the use of indices that themselves are not investments, typically provide in their agreements that they do not manage assets, make investment recommendations, or serve as an investment adviser, and they require each licensee that offers an indexed fund or product to inform third parties (including in any prospectus) of this. Thus, the core components of investment advice as defined in the Advisers

[34] Request for Comment at 15.
[35] *See* 15 U.S.C. § 80b–2(a)(11).
[36] *See, e.g.*, SEC, Division of Investment Management No-Action Letter: RDM Infodustries, Inc., https://www.sec.gov/divisions/investment/noaction/1996/rfminfodustries032596.pdf.
[37] *See, e.g.*, Mayer Brown LLP, *Indices: The Good, the Bad and Knowing the Difference* (2019), https://www.mayerbrown.com/-/media/files/perspectives-events/publications/2019/02/white-paper-converted.pdf.
[38] *See, e.g.*, BlackRock, *iShares Investigates: Market Indexes and Index Investing*, https://www.ishares.com/us/literature/whitepaper/ishares-investigates-indexes-and-index-investing-en-us.pdf

Act – namely the provision of "advice" or "analysis of merits" – are outside the scope of the activities of the index provider.

ii) The Publisher Exception

Even if index providers were to meet the definition of "investment adviser" under the Advisers Act, they would qualify for the exception from regulation as such for "the publisher of any bona fide newspaper, news magazine or business or financial publication of general and regular circulation" (the "**Publisher Exception**").[39]

In *Lowe v. SEC* (1985), the Supreme Court held that to qualify for the Publisher Exception a publication must (i) offer only impersonal advice not tailored to the individual needs of a specific client, group of clients, or portfolio; (ii) contain only disinterested commentary and analysis rather than promotional material disseminated by someone touting particular securities; and (iii) be of general and regular circulation rather than issued in response to episodic market activity or events.[40]

Index providers' construction, calculation, and publication of indices fulfill the criteria of the Publisher's Exception as delineated in *Lowe*. First, even if the mere publication of indices were to constitute "advice," indices are not personalized to any client, group of clients, or portfolio. Any modification to an index that is requested by a licensee cannot be deemed to be advice from the index provider, let alone personalized advice, because the modification is not proposed or recommended by the index provider but rather by the licensee. It is not the index provider's role to assess the merits of the investment strategy the licensee intends to pursue using the index. Second, the construction and publication of an index are "disinterested commentary" because they do not imply a belief that the constituent securities are expected to appreciate or depreciate but is rather a means to measure the performance of that set of assets in accordance with predefined and transparent rules. The index provider thus does not "promote" or "tout" particular securities. It is the fund's board and adviser that control the objective, strategy, and marketing of any fund that uses the index. Third, indices are published on a regular and consistent basis, typically daily or in real time, rather than in response to specific market activity or events. Each of the three prongs of the Publisher Exception as delineated in *Lowe* is thus met.

iii) The Company Act

Index providers are not "investment advisers" to investment companies under the Company Act.

The Company Act defines "investment adviser of an investment company" as "(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) of this paragraph regularly performs substantially all of the duties undertaken by such person described in said clause (A) . . . ."[41]

Neither Clause (A) nor Clause (B) of the above definition applies to index providers.

[39] *See* 15 U.S.C. § 80b–2(a)(11)(D).
[40] *See* Lowe v. SEC, 472 U.S. 181, 209-210 (1985). *See also* SEC v. Park, 99 F. Supp. 2d 889, 895-896 (N.D. Ill. 2000).
[41] *See* 15 U.S.C. § 80a–2(a)(20).

Clause (A) requires that there be a contract between the adviser and investment company. Index providers however typically license their indices by contracting with investment advisers, not investment companies. Clause (A) also does not apply for the independent reason that the index provider does not provide advice as to the desirability of buying, selling or investing in securities or determine what property an investment company buys or sells, as discussed in subsection (ii) above.

Clause (B) does not apply because an index provider does not "regularly perform substantially all of the duties" of an investment adviser to an investment company. It is the company's adviser, at the direction of the board, that continues to manage the investment company, select which index is used, and design and execute trading strategies in relation to that index. The index provider's work is thus incorporated into the investment company's strategy, but responsibility for the design of the strategy and the index's role therein remains solely with the investment company's board and adviser. The index provider thus certainly does not *regularly perform substantially all* of the duties of the investment adviser under Clause (B) of the definition.

Moreover, the Company Act also contains a publisher exception for any "person whose advice is furnished solely through uniform publications distributed to subscribers thereto."[42] As noted earlier, index providers make their indices generally available to subscribers with a uniform style, form, and content. Thus, even assuming the index provider were to meet the Company Act's definition of "investment adviser," the index provider would still be excluded from regulation as such under the Company Act's publisher exception.

Part III: Regulating index providers as investment advisers is unnecessary and undesirable from a policy perspective.

The Request for Comment also seeks feedback on the costs and benefits of regulating index providers as investment advisers,[43] as distinct from the legal question of whether they currently meet the definition of that term. For the reasons discussed in this section, regulating index providers as investment advisers would likely impose significant costs and produce few benefits, and would thus be unnecessary and undesirable from a policy perspective. First, the vehicles through which investors most commonly invest in index-tracking strategies – namely index funds – and the advisors to those index funds are already subject to comprehensive regulation under both the Advisers Act and the Company Act. Second, frameworks for the regulation of index providers already exist. To the extent concerns regarding the appropriate regulatory framework for index providers are valid, they would be better addressed within these frameworks. Furthermore, we note that the extent of index provider discretion over index inclusion and rebalancing is narrower than as is suggested in the Request for Comment and has not caused any major issues. Finally, empirical evidence indicates, despite suggestions to the contrary, that index inclusion decisions do not have a lasting effect on security prices.

i) Regulation of index funds and their advisers already protects investors in index funds.

As described in Part I, it is the manager of an index fund that determines the advisability of investing in a set of assets that relates to an index, the nature of the relationship between the index and the fund's portfolio (e.g., long vs. short), and the instruments through which the fund gains exposure to the index (e.g., physical positions vs. derivatives). Index fund managers are already regulated as "investment advisers" under the Advisers Act and Company Act and are thus subject

[42] *See* 15 U.S.C. § 80a–2(a)(20).
[43] Request for Comment at 19-20.

to the extensive regulatory requirements described in Part I above.[44] Regulating index providers as investment advisers would likely produce no identifiable marginal benefit, since concerns regarding the ways in which fund managers use index products are addressed via the existing regulatory framework that applies to investment advisers and investment companies.

Regulating index providers as investment advisers risks imposing significant costs. If index providers were deemed to be investment advisers, then they would owe fiduciary duties to their subscriber-clients that would be problematic.[45] For example, index providers are generally seeking to respond to a demand from market participants for an accurate measure of a particular subsection of the investable market regardless of how the market performs. If an asset class tracked by an index performs poorly, then the index is expected to reflect that performance accurately. However, if an index provider were to owe fiduciary duties to its subscribers, then an index provider may be subject to litigation risk if an index that it constructs depreciates, notwithstanding that the very purpose of the index was to accurately represent the segment of the market that depreciated. This risk may be particularly acute because of potential uncertainty surrounding whether the index provider's fiduciary duties are owed to the fund adviser, the fund itself, the fund's investors, or some combination of the foregoing. Index providers might then curtail their activities or raise the cost of their services, thus depriving the market of a useful investment tool.

Furthermore, changing the regulatory status of an index provider into that of an investment adviser could result in conflicting fiduciary obligations if, to take one example, an index provider as investment adviser were to have a view on the appropriateness or suitability of an index that differed from that of the existing investment adviser. Such conflicts, or two pairs of hands "on the same steering wheel," would be complex and very costly to administer, and time consuming to resolve to the detriment of confused investors. It would also introduce confusion as to whether the fund adviser's fiduciary duties are reduced to the extent of the index provider's assumption of fiduciary duties. Index providers likely would need to raise their fees in view of the specter of unclear, conflicting fiduciary obligations and with them, significant liability in view of the very large amounts of assets involved.

ii) A regulatory framework specific to index providers already exists.

Index providers are already operating within a regulatory framework that addresses concerns about governance, conflicts of interest, and transparency, among other things. Though much of this framework is based on voluntary compliance, to the extent that regulators wish to ensure that such issues are addressed or are concerned that index providers retain too much discretion over their methodologies[46], discrete elements from these existing frameworks could be promulgated on a mandatory or comply-or-explain basis, thus minimizing the costs of additional regulatory burdens.

The largest index providers in the United States, including Bloomberg, MSCI, and S&P Dow Jones, have complied voluntarily with the "Principles for Financial Benchmarks" published by the International Organization of Securities Commissions (the "**IOSCO Principles**") since shortly

[44] *See* 15 U.S.C. § 80b–2(a)(11); 15 U.S.C. § 80a–2(a)(20).

[45] *See, e.g.*, U.S. SEC. & EXCH. COMM'N, *Commission Interpretation Regarding Standard of Conduct for Investment Advisers*, 84 FED. REG. 33669 (July 12, 2019), https://www.federalregister.gov/documents/2019/07/12/2019-12208/commission-interpretation-regarding-standard-of-conduct-for-investment-advisers.

[46] *See, e.g.*, Comm'n Robert J. Jackson Jr., SEC, *What's Really in Your Index Fund* (Feb. 18, 2019), https://www.sec.gov/news/speech/jackson-your-index-fund (noting that

after their release nearly a decade ago.[47] The IOSCO Principles provide robust and comprehensive guidance for index providers concerning:

- governance, including conflicts of interest;
- benchmark quality, including design, data inputs, transparency, and review;
- methodology quality, including changes and internal controls; and
- accountability, including audit and complaint procedures.[48]

Members of the Index Industry Association ("**IIA**") also are required to comply with the IOSCO Principles, in addition to IIA best practices and local regulations.[49] Index providers that adhere to the IOSCO Principles undergo regular audits by external auditors to certify compliance.[50] Major index providers are thus already voluntarily operating within a regulatory framework that is specific to their function and operation.

There are also certain obligations that apply to index providers on a mandatory basis: in particular, index providers and their employees are prohibited from trading on, or causing others to trade on, material non-public information that they possess regarding which securities will or will not be included in an index.[51]

iii) Regulation of index providers as investment advisers mischaracterizes the role of index providers and would impose unnecessary costs.

The Request for Comment refers to a proposal in the academic literature that would regulate certain index providers as investment advisers.[52] Mahoney & Robertson (2021) propose a rule change that would require index providers to register as investment advisers unless they meet a safe harbor for providers of generalized indices, who must adhere to certain anti-conflict of interest requirements.[53]

The proposal underestimates the regulatory burden it would entail by subjecting index providers to fiduciary duties and SEC reporting and examination. Also, its case, and the case more generally, for regulation of customized indices as investment advisers is based on a mischaracterization of the division of responsibility between a customized index provider and investment adviser. For example, the proposal would treat any request from an investment adviser to an index provider to create a new index or modify an existing index as "personalized advice" from the provider to the adviser. A *directive or request* from an investment adviser to an index provider cannot reasonably be construed as the provision of *advice* from the latter to the former. Nor should the index provider's response to that request be so characterized, since the designer of a customized index is only identifying securities that meet the criteria that a fund manager has developed and specified, as informed by the governance standards described above. Because the fund manager is the

[47] INT'L ORG. OF SEC. COMM'NS, *Principles for Financial Benchmarks* (July 2013), https://www.iosco.org/library/pubdocs/pdf/IOSCOPD415.pdf.

[48] *See id.* at 15-29, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD415.pdf.

[49] *See* INDEX INDUS. ASSOC. IIA Advocacy http://www.indexindustry.org/advocacy/#:~:text=The%20IIA%20and%20its%20members%20have%20led%20the,IOSCO%20Principles%2C%20and%20local%20regulations.%20Indexes%E2%80%99%20Five%20Truths (last visited Jul. 14, 2022).

[50] *See, e.g.*, S&P DOW JONES INDICES, *Management Statement of Adherence with the IOSCO Principles for Financial Benchmarks, For the period June 1, 2020 through May 31, 2021*, 5-6 (accessed May 2022), https://www.spglobal.com/spdji/en/documents/legal/spdji-iosco-report-2021.pdf. MSCI is a registered benchmark administrator in the United Kingdom and his integrated compliance with the IOSCO Principles and UK BMR.

[51] 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5.

[52] *See*, Request for Comment at 4, citing Mahoney, *supra* note 8.

[53] *See* Mahoney & Robertson, *supra* note 8, at 42-48.

originator of these criteria, a customized index is in fact more likely than a generalized index to be the intellectual property of the fund manager adviser and not that of the index provider. Any changes the fund adviser is thereby entitled to make to the index and the manner in which the fund adviser uses the index remain the responsibility of the fund adviser and the fund's board, in light of their fiduciary duties to fund investors. Thus, the provider of a customized index is often even further removed from the process of determining the "advisability of investing in, purchasing, or selling securities," which remains the responsibility of the fund adviser.

The proposal also suggests that if customized index providers were to be excluded from the definition of investment adviser, the adviser of an index fund could escape regulation as such simply by re-characterizing itself as an index provider. This argument ignores basic characteristics of index investing. Construction of an index as a representation of a segment of the investable market is fundamentally distinct from a determination that the constituent assets are a suitable investment and from the process of determining how to obtain investment exposure to the index. By selecting an index for use by a fund, the investment adviser has not transferred any of its responsibilities to the index provider.

Any concerns with conflicts of interest between index providers and investment advisers or investors, methodological transparency, or other aspects of the construction and offering of financial indices could be addressed by tailored regulatory solutions. They do not require the unprecedented expansion of a regulatory regime that was designed for entirely different purposes – that is, the rules governing the conduct of investment advisers. For example, when the European Union adopted its Benchmarks Regulation, it imposed certain obligations on index providers concerning registration, governance, transparency, and accountability consistent with the IOSCO Principles.[54]

Finally, the SEC has long recognized indices as a valuable source of information for investors and their advisers, even requiring that funds publicly identify broad-based indices as benchmarks. It has not until recently suggested that index providers could be registered as investment advisers. Such a significant departure from an existing regulatory framework should not be undertaken without a clear expression of congressional intent.

iv) Index provider discretion is subject to objective criteria and market discipline; empirical evidence indicates that the "index premium" has dissipated.

As index fund assets under management have grown, commentators have noted the increasing importance of indices to the allocation of capital in the United States and internationally. Some have argued that the extent of index provider discretion over inclusion and rebalancing and the potential effect of adding or excluding an issuer from a major index on that issuer's stock price warrant further regulation.[55]

The Request for Comment alludes to these arguments when it states that an index provider's decisions as to the inclusion, exclusion, and rebalancing of an index leaves room "for significant discretion" and that index providers in some cases undertake these activities "without publicly disclosing their index methodologies."[56] However, the major providers of indices of general

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[54] Regulation (EU) 2016/1011 of the European Parliament and of the Counsel of 8 June 2016, https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32016R1011&from=EN (the "**EU BMR**").

[55] Comm'n Robert J. Jackson Jr., SEC, *What's Really in Your Index Fund* (Feb. 18, 2019), https://www.sec.gov/news/speech/jackson-your-index-fund.

[56] Request for Comment at 4-5.

availability (i.e., S&P, MSCI, FTSE Russell, Bloomberg), as well as many other independent index providers, publicly disclose their contents and methodologies and adhere to the IOSCO Principles. As a result, index providers have brought about significantly greater transparency in the contents of investment fund portfolios. To the extent certain of a provider's decisions as to index constituents involve discretion, the scope of that discretion is limited by express and objective criteria.[57] Moreover, the exercise of this discretion has long been visible to the marketplace.[58] Investment advisers and the company's board can thus assess whether a change or rebalancing of an index is consistent with the objective of accurately representing the sector of the marketplace that the index purports to measure and more generally whether continued use of that index is consistent with their fiduciary duties to their clients.[59]

As the Request for Comment also notes, certain empirical studies have suggested that the addition or removal of a security to or from a prominent index can result in a short-term increase or decrease, as applicable, in the price of that security as index funds respond to the change (an "index premium").[60] The existence of an index premium could indicate that price changes are not driven by fundamental information as they should be in an efficient market, and thus indicate a potential negative price efficiency impact of index investing. However, a more recent set of studies indicates that the index premium has decreased or disappeared. For example, Scari (2016) found that the index premium declined starting in the late 1990s and disappeared entirely by 2010.[61] Schitzler (2016) and Patel (2017) found that the index premium has effectively disappeared.[62]

[57] IOSCO Principle 8 requires the establishment of clear guidelines regarding the hierarchy of data inputs and the exercise of discretion by the administrator for the determination of a benchmark.

[58] IOSCO Principle 12 requires the publication of the rationale of any proposed material change in benchmark methodology and the procedures for making such changes.

[59] *See, e.g.*, Vanguard S&P 500 Prospectus https://advisors.vanguard.com/pub/Pdf/p040.pdf ("The Fund reserves the right to substitute a different index for the index it currently tracks . . . for any other reason determined in good faith by the Fund's board of trustees.").

[60] Request for Comment at 23; *see also* Massimo Massa, Urs Peyer and Zhenxu Tong, Limits of Arbitrage and Corporate Financial Policy, CEPR DISCUSSION PAPER 4829 (2005), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=702981.

[61] Cameron Scari, On the Changes to the Index Inclusion Effect with Increasing Passive Investment Management (2016), https://repository.upenn.edu/cgi/viewcontent.cgi?article=1020&context=joseph_wharton_scholars.

[62] Jan Schitzler, S&P 500 Inclusions and Stock Supply, J. OF EMPIRICAL FIN. (2016), http://janschnitzler.com/wp-content/uploads/2016/12/sp500.pdf; Nimesh Patel & Ivo Welch, Extended Stock Returns in Response to S&P 500 Index Changes, Review of Asset Pricing Studies, 7(2) THE REVIEW OF ASSET PRICING STUDIES 172 (2017).

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Thank you very much for your consideration of the Committee's position. Should you have any questions or concerns, please do not hesitate to contact the Committee's President, Professor Hal S. Scott (hscott@law.harvard.edu), or its Executive Director, John Gulliver (jgulliver@capmktsreg.org), at your convenience.

Respectfully submitted,

Robert Glenn Hubbard

John L. Thornton
Co-CHAIR

Hal S. Scott
PRESIDENT

R. Glenn Hubbard
Co-CHAIR

ANNEX A

Select Published Methodology Documents of Major Index Providers

Index Provider	Document	Location
Bloomberg	Global Equity Indices Methodology	https://assets.bbhub.io/professional/sites/10/Global-Equity-Index-Methodology.pdf
Bloomberg	Global Market-Cap Equity Indices Corporate Action Methodology	https://assets.bbhub.io/professional/sites/27/Bloomberg-Global-Equity-Indices_Corp-Action-Methodology_Sept2021.pdf
FTSE Russell	FTSE Global Equity Index Series	https://research.ftserussell.com/products/downloads/ftse_global_equity_index_series.pdf
FTSE Russell	Guide to Calculation FTSE Global Equity Index Series	https://research.ftserussell.com/products/downloads/FTSE_Global_Equity_Index_Series_Guide_to_Calc.pdf
FTSE Russell	Corporate Actions and Events Guide for Market Capitalisation Weighted Indices	https://research.ftserussell.com/products/downloads/Corporate_Actions_and_Events_Guide.pdf
FTSE Russell	Industry Classification Benchmark (Equity)	https://research.ftserussell.com/products/downloads/ICB_Rules_new.pdf
MSCI	Index Calculation Methodology	https://www.msci.com/eqb/methodology/meth_docs/MSCI_IndexCalcMethodology_Feb2022.pdf
MSCI	Global Investable Market Indexes Methodology	https://www.msci.com/eqb/methodology/meth_docs/MSCI_GIMIMethodology_Mar2022.pdf
MSCI	Corporate Events Methodology	https://www.msci.com/eqb/methodology/meth_docs/MSCI_CEMethodology_Feb2022.pdf
MSCI	Global Industry Classification Standard (GICS) Methodology	https://www.msci.com/documents/1296102/11185224/GICS+Methodology+2022.pdf/f9910041-6127-17d2-1246-4052926adaf7?t=1645738126436
MSCI	Index Policies	https://www.msci.com/eqb/methodology/meth_docs/MSCI_Index_Policies_Nov_2020_Release.pdf
S&P Dow Jones	S&P U.S. Indices Methodology	https://www.spglobal.com/spdji/en/documents/methodologies/methodology-sp-us-indices.pdf
S&P Dow Jones	Index Mathematics Methodology	https://www.spglobal.com/spdji/en/documents/methodologies/methodology-index-math.pdf
S&P Dow Jones	S&P Float Adjustment Methodology	https://www.spglobal.com/spdji/en/documents/methodologies/methodology-index-math.pdf
S&P Dow Jones	Global Industry Classification Standard (GICS) Methodology	https://www.spglobal.com/spdji/en/documents/methodologies/methodology-gics.pdf
S&P Dow Jones	Equity Indices Policies & Practices Methodology	https://www.spglobal.com/spdji/en/documents/methodologies/methodology-sp-equity-indices-policies-practices.pdf