

**MEMO# 34186**

June 23, 2022

# SEC Issues Request for Comment on Index Providers, Model Portfolio Providers, and Pricing Services

[34186]

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TO: ICI Members

Investment Company Directors SUBJECTS: Audit and Attest

Audit Committees

Compliance

Exchange-Traded Funds (ETFs)

Fund Accounting & Financial Reporting

Fund Governance

Intermediary Oversight

Investment Advisers

Operations

Risk Oversight

Valuation RE: SEC Issues Request for Comment on Index Providers, Model Portfolio Providers, and Pricing Services

Last week, the SEC issued a request for comment on index providers, model portfolio providers, and pricing services ("information providers").[\[1\]](#) 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.

Comments are due to the SEC by August 16.

## Background

The release states that the role of information providers has grown in recent years, raising "status" issues under the Advisers Act. It notes that their operations also raise questions about investor protection and market risk. The release then briefly describes each type of information provider:

- Index providers "compile, create the methodology for, sponsor, administer, and/or license market indexes."[\[2\]](#) The release describes the discretionary aspects of their activities, the growth in the number and variety of indexes, the nature of their

compensation, the relative concentration of the industry, and the increasing specialization of indexes.

- Model portfolio providers include broker-dealers, asset managers, third-party strategists, asset allocators, and advisers. A model portfolio consists of "a diversified group of assets (often mutual funds or exchange-traded funds ('ETFs')) designed to achieve a particular expected return with exposure to corresponding risks."[\[3\]](#) The release describes the degrees of model customization, the growing demand for ESG-focused models, the nature of compensation, and investment advisers' use of third-party models.
- 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."[\[4\]](#) The release describes the services' degree of discretion (e.g., in determining methodologies, models, and inputs), the nature of their compensation, and their treatment under Rule 2a-5.

The release analyzes "investment adviser" status under the Advisers Act, including its key elements and exclusions (e.g., the "publisher's exclusion").[\[5\]](#) It expresses the SEC's belief that index providers have relied on the publisher's exclusion. The release also discusses the implications of registration and applicability of the Act's provisions to these entities.

## **Key Questions in the Release**

From the perspective of funds and fund advisers, some of the more relevant questions posed in the release include the following:

### **Questions of general applicability**

- What types of potential risks and conflicts of interest does each type of provider present?
- How do information providers exercise discretion in providing information? For example, do index providers or model portfolio providers create indexes or portfolios at the request of their licensees or users based on more customized investment objectives and goals?
- To what extent, and under what circumstances, does each type of information provider personalize the services it offers? For example, what are industry practices around direct indexing and specialized indexes, and how prevalent are they?
- Under what circumstances do information providers disclose changes or updates to the services provided, and to whom?
- How, and in what form, are information providers compensated?
- Should the SEC exempt any of the information providers from the definition of "investment adviser"?
- What are the economic benefits and costs associated with investment adviser status for each information provider?
- What would be the effect of registration on the ability of new competitors to come into the marketplace?
- What information do registered advisers and investment companies currently submit to the SEC with respect to their information providers? What information, if any, should registrants be required to submit?
- Should Form ADV require specific information about advisers' use of information providers?

## **Questions applicable to index providers**

- Is there a difference between users of broad-based indexes and specialized indexes?
- Under what circumstances, if any, is an index provider compensated based on the amount of assets that are managed according to its index? Do compensation methods for index providers differ based on whether they provide broad-based indexes or specialized indexes?
- What are the economic benefits and costs associated with investment adviser status for index providers that develop broad-based indexes versus specialized indexes?
- Should any U.S. regulatory action, if adopted and implemented, be aligned with the framework placed by the EU Benchmarks Regulation (BMR)? Are there particular components of the BMR that should or should not be applied to index providers in the U.S., and why? What has been the effect of the BMR on the provision of benchmarks and indexes in the EU?

## **Questions applicable to model portfolio providers**

- Do model portfolio providers raise different investment adviser status issues than those raised by index providers that provide specialized indexes? In what ways are they distinguishable?

## **Questions applicable to pricing services**

- Is there a distinction between typical pricing services in the market and a "valuation specialist" that exercises informed judgment in determining valuation inputs, methodologies, and the legitimacy of a valuation conclusion?
- To what extent do the results of price challenges to a pricing service's values affect the prices provided to other users of pricing services? Are there times when a pricing service aggregates or delivers information from another pricing service?

## **Related Investment Company Act Matters**

The release explains that the Investment Company Act's definition of "investment adviser" differs from that in the Advisers Act. It 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)." [\[6\]](#) The release then analyzes the information providers' activities with respect to this statute's definition of "investment adviser."

The release concludes by posing the following questions (among others):

- What are the economic benefits and costs associated with whether a provider meets the Investment Company Act's definition of "investment adviser" of a fund?
- To what extent do providers contract directly with funds?
- To what extent do providers distribute uniform publications?
- To what extent do funds currently extend their Rule 38a-1 compliance program to information providers, where such entity is not considered an investment adviser or one of the rule's other named service providers (principal underwriters, administrators and transfer agents)? Does this analysis differ depending on the provider? Should we

amend Rule 38a-1 to incorporate information providers within a fund's compliance program, rather than requiring registration of information providers as investment advisers? What would be the costs and benefits of such an approach?

- In circumstances where a fund's adviser contracts with an information provider, how much information is provided to the fund's board regarding the providers on an ongoing basis? Do fund boards approve the engagement of providers in these circumstances? Does this differ depending on the provider?

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#### **endnotes**

[1] 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](http://www.sec.gov/rules/other/2022/ia-6050.pdf).

[2] Release at 4.

[3] Release at 7. The release also clarifies that its discussion "focuses on third-party model portfolio providers that sell models to wealth managers that apply them to client portfolios (or make available selected models to clients) versus internal firm models." Release at n.13.

[4] Release at 9.

[5] The Act excludes from the definition of "investment adviser" the "publisher of any bona fide newspaper, news magazine or business or financial publication of general and regular circulation."

[6] Release at 28-29.