

August 15, 2022

Ms. Vanessa A. Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Submitted via email: rule-comments@sec.gov

Re: Request for Comment on Certain Information Providers Acting as Investment Advisers; Release Nos. IA-6050; IC-34618; File No. S7-18-22

Dear Ms. Countryman,

MSCI Inc. (“MSCI”) respectfully submits this letter in response to the above-referenced request for comment (the “RFC”) by the U.S. Securities and Exchange Commission (the “Commission”). We thank the Commission for inviting engagement from the market.

MSCI has been at the forefront of index construction, calculation and maintenance for more than 50 years, having launched our first global equity indexes in 1969. Our indexes are used by a variety of institutional clients, including asset managers, asset owners, banks, insurance companies and wealth managers. We do not offer index products and services to retail investors. We administer our indexes in an objective manner by applying a rules-based approach¹ and recognize the importance of principles of conduct that promote index governance, quality and transparency. For these reasons, MSCI welcomed, and adheres to, the Principles for Financial Benchmarks² published by the International Organization of Securities Commissions (“IOSCO”). The IOSCO Principles were specifically developed to address the unique role of benchmark and index providers and have served to effectively promote sound practices of index providers globally since their adoption in 2013.

The RFC suggests extending an existing regulatory framework for investment advisers to index providers, despite fundamental differences between the IOSCO Principles and the obligations of investment advisers acting as fiduciaries for their clients under U.S. federal and state laws. We disagree that index providers can, or should, be treated as investment

¹ MSCI methodology documents outline index objectives and detail the rules and guidelines followed by MSCI to create and maintain MSCI indexes in a wide set of possible circumstances, including situations of market stress. MSCI’s rules-based index methodologies are designed to ensure that indexes are determined with integrity and that discretion is not used in the production of the indexes except in rare cases not effectively addressed by the methodology.

Prior to making any material change to an index methodology, MSCI conducts a broad public consultation with global market participants. Public consultations provide essential feedback, facilitate transparency, fuel innovation and improvement, and ensure the on-going relevance of the indexes. Please refer to https://www.msci.com/eqb/methodology/meth_docs/MSCI_Index_Policies_June_2022.pdf for more information on our index policies.

² See *Principles for Financial Benchmarks, Final Report*, The Board of International Organization of Securities Commissions, July 2013); available at <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD415.pdf> (the “IOSCO Principles”).

advisers, and submit that such an outcome would not only directly contradict federal securities laws, their longstanding interpretation and established market practice, but also introduce significant negative consequences for the domestic markets, including increased costs for U.S. investors.

In response to the Commission's questions in the RFC, we set out our key observations below and then provide a deeper discussion of these points.

Index providers are not investment advisers

Index providers do not engage in any of the activities of investment advisers and do not meet the statutory definitions of an "investment adviser". Designing, calculating and licensing an index does not constitute or involve the provision of investment advice.³

Index providers do not build or manage investment portfolios, but rather calculate the performance of a set of securities such as a country, sector or style (e.g., value or growth). Index providers are data suppliers to investment advisers and other sophisticated market participants. An index is simply a weighted average of a group of Index Constituents, not a recommendation to buy, sell or hold Index Constituents, an assessment of the value or potential return of those Index Constituents or an analysis or a report concerning the Index Constituents.

This does not change in the context of what the RFC calls "specialized" indexes (custom or bespoke) or "direct indexing".⁴ MSCI permits licensees to customize an index by requesting changes, which we then calculate applying the client-defined criteria and our underlying core index construction and index governance processes. Custom indexes vary a great deal in scope and complexity. For example, a custom index could simply remove a country from a global or regional index (e.g., MSCI World ex-USA, or MSCI Asia ex-Japan), or could exclude sectors in which a portfolio does not invest in (e.g., MSCI USA ex-Tobacco). Other examples of customizations that clients design to reflect their portfolio strategies and constraints could include weighting caps of certain sectors, changes to liquidity or other eligibility requirements for index inclusion, or other requested modifications designed by licensees. Custom indexes, just like standard indexes, simply compute the return of an identified group of Index Constituents.

The activities of index providers are not contemplated by the definition of an "investment adviser" under either the Investment Advisers Act of 1940 (the "Investment Advisers Act") or the Investment Company Act of 1940 (the "Investment Company Act"). Even if there were somehow a credible argument that index providers did meet the definition of an "investment adviser," the publication and licensing of indexes clearly fall within the publisher's exclusion under both statutes.

Classifying index providers as investment advisers would introduce confusion and conflicts of interest and impede the strength of the U.S. capital markets

³ By analogy, consider a common non-financial index such as a consumer price index (CPI). A CPI measures the average change in prices over time of a fixed basket of goods and services. It provides information to consumers about movements in the price of goods, not recommendations or advice on what to buy. The same logic applies to financial indexes that measure the aggregate performance of a group of securities, commodities or other assets ("Index Constituents").

⁴ For convenience and consistent with industry practice, we generically refer to these types of indexes herein as "custom indexes".

Index providers have a clearly defined and limited role in the capital markets ecosystem: to design index methodologies, apply the methodology, calculate the associated indexes, and publish and license that information to market participants to use for a variety of purposes including performance benchmarking, research, reporting, and indexed product creation.⁵ An investment adviser, on the other hand, is paid for providing investment advice about securities to its clients.

The Commission has noted that a critical element of an investment adviser's fiduciary duty to each of its clients is "[t]he duty to provide advice that is in the best interest of the client based on a reasonable understanding of the client's objectives."⁶ This fiduciary duty is fundamentally at odds with the role of index providers in the capital markets ecosystem, which is to produce independent and rules-based information for use by market participants. Even if index providers had the necessary expertise and information to exercise such a duty (which they do not), would that mean that every client must receive a unique index suitable and tailored to that client's specific objectives? That is not possible, practical or necessary. Clients request indexes (both standard and custom) from index providers and determine which indexes to use and for what purposes; index providers do not recommend indexes (standard or custom) to their clients to achieve a particular investment outcome. Further, fulfilling a fiduciary duty would seemingly conflict with an index provider's duty to be "independent" under the benchmark regulations in the European Union ("EU") and United Kingdom ("UK").⁷

In addition to the confusion and conflicts that an investment adviser designation for index providers would bring, index providers would also face significant new risks as fiduciaries, including increased litigation risk. In turn, index providers would need to raise their licensing fees to compensate for their increased risks and responsibilities, which would likely be passed on by fund sponsors to investors in the form of higher ongoing fund operating costs embedded in fund expense ratios, thereby potentially reducing the availability of lower-cost funds.

There is already an existing framework under the IOSCO Principles to address regulatory concerns

Since their publication nearly a decade ago, the IOSCO Principles set forth principles of conduct for index providers that have been widely adopted by independent index providers operating in the U.S. Rather than departing from the IOSCO Principles by categorizing index providers as investment advisers, the Commission could leverage the IOSCO Principles and require registered investment advisers or funds to ensure that any index they use is administered by an index provider that has adopted, and abides by, the IOSCO Principles. This would be a practical and proportional alternative that would achieve the Commission's underlying objectives without triggering significant negative consequences for the U.S. capital markets.

⁵ See the website of the Index Industry Association; available at <https://www.indexindustry.org/advocacy/>

⁶ Commission Interpretation Regarding Standard of Conduct for Investment Advisers, Release No. IA-5248 (June 5, 2019) at 13; available at <https://www.sec.gov/rules/interp/2019/ia-5248.pdf>.

⁷ See article 4(1) of the EU Benchmark Regulation ("EU BMR"):

Administrators shall take adequate steps to identify and to prevent or manage conflicts of interest between themselves, including their managers, employees or any person directly or indirectly linked to them by control, and contributors or users, and to ensure that, where any judgement or discretion in the benchmark determination process is required, it is independently and honestly exercised.

We now turn to a deeper discussion of these key points:

1. Index providers are not investment advisers under law

Index providers are not investment advisers under the Investment Advisers Act

The definition of “investment adviser” appears in Section 2(a)(11) of the Investment Advisers Act and, in pertinent part, defines an “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...

In constructing and calculating indexes, index providers do not for compensation, engage in the business of “advising others...as to the value of securities or as to the advisability of investing in, purchasing or selling securities...”. Index providers do not “issu[e] or promulgat[e] analyses or reports concerning securities,” as indexes are neither “analyses” nor “reports.”⁸

In the course of their regular index business activities, index providers:

- express no opinion or view as to whether any market, company, strategy or investment is good or bad, or appropriate or inappropriate;
- do not manage assets or report assets under management;
- do not recommend or promote asset allocations, investments or investment strategies;
- do not offer, manage, recommend, market or promote investments, including any funds, exchange traded funds (“ETFs”) or other investment products linked to their indexes;
- do not determine the securities in which a particular fund, ETF or other instrument invests; and

⁸ The Commission staff has adopted a three-factor test to determine whether information relating to securities constitutes an analysis or report within the definition of “investment adviser.” See J. D. Manning, Inc., SEC No-Action Letter, 1986 SEC No-Act. LEXIS 1652 (Jan. 21, 1986). The test and any analysis thereunder presumes that the information in question resembles a report or an analysis (e.g. a newsletter, monthly report or database that analyzes funds or stocks). An index does not fit that category and, in any event, an index satisfies the three-prong test: (i) the underlying data is readily available to the public in its raw state (index providers obtain the underlying data from public sources), (ii) the information is not highly selective (indexes do not selectively choose information, they uniformly apply an index methodology), and (iii) the information is not presented in a manner that suggests purchasing, holding or selling any security (indexes are delivered impartially as data files). See, e.g., J. D. Manning, Inc., SEC No-Action Letter, 1986 SEC No-Act. LEXIS 1652 (Jan. 21, 1986); RDM Infodustries, Inc., SEC No-Action Letter, 1996 SEC No-Act. LEXIS 492 (Mar. 25, 1996); Mo. Innovation Ctr., Inc., SEC No-Action Letter, 1995 SEC No-Act. LEXIS 783 (Oct. 17, 1995); Datastream Int’l., Inc., SEC No-Action Letter, 1993 SEC No-Act. LEXIS 735 (Mar. 15, 1993); Harold M. Lucero, SEC No-Action Letter, 1992 SEC No-Act. LEXIS 1171 (Dec. 24, 1992); Charles Street Sec., Inc., SEC No-Action Letter, 1987 SEC No-Act. LEXIS 1662 (Feb. 27, 1987); Butcher & Singer, Inc., SEC No-Action Letter, 1987 SEC No-Act. LEXIS 1477 (Jan. 2, 1987); Wallace E. Lin, SEC No-Action Letter, 1985 SEC No-Act. LEXIS 2068 (Apr. 15, 1985); NoLoad Mut. Fund Ass’n, SEC No-Action Letter, 1984 SEC No-Act. LEXIS 2910 (Dec. 31, 1984); Richard Daniels, SEC No-Action Letter, 1984 SEC No-Act. LEXIS 2874 (Dec. 19, 1984); Jack Sonner, SEC No-Action Letter, 1983 SEC No-Act. LEXIS 2262 (Mar. 11, 1983); Michael R. Kaus, SEC No-Action Letter, 1982 SEC No-Act. LEXIS 1905 (Feb. 8, 1982); Butcher & Singer, Inc., SEC No-Action Letter, 1987 SEC No-Act. LEXIS 1477 (Jan. 2, 1987); CSAS, Inc., SEC No-Action Letter, 1981 SEC No-Act. LEXIS 4123 (Oct. 1, 1981).

- are not delegated any advisory or management responsibilities by an investment adviser (including an adviser to a fund).

MSCI furthermore informs its clients in its index license agreement that it does not manage assets, make investment recommendations, or serve as an investment adviser, and requires each licensee (and sub-licensee) that designs, manages or offers an indexed financial product to inform third parties (including in any prospectus delivered to investors in the licensee's indexed financial products) of the same.

Index providers are therefore not investment advisers under the Investment Advisers Act.

Index providers would qualify for the "publisher's exclusion" under the Investment Advisers Act

Even if a different conclusion were reached and index providers were deemed "investment advisers" under the Investment Advisers Act, the activities of index providers fall squarely within the so-called "publisher's exclusion" contained in the definition of "investment adviser" under the Investment Advisers Act.⁹

The United States Supreme Court interpreted the publisher's exclusion in *Lowe v. U.S. Securities and Exchange Commission*¹⁰ and held that a person's publication of investment newsletters not offering personalized advice falls within the statutory exclusion from the Investment Advisers Act. The Court concluded that in order to qualify for this exclusion, a publication must satisfy three elements:¹¹

- (1) the publication must offer only impersonal advice, *i.e.*, advice not tailored to the individual needs of a specific client, group of clients, or portfolio;
- (2) the publication must be "*bona fide*", containing disinterested commentary and analysis rather than promotional material disseminated by someone touting particular securities, or information distributed as an incident to personalized investment services; and
- (3) the publication must be of general and regular circulation rather than issued from time to time in response to episodic market activity or events affecting the securities industry.

Applying the *Lowe* factors to the products produced by index providers, the construction and calculation of indexes clearly and undoubtedly meet the three prongs of the test.

- (1) *Index providers do not offer "advice" – impersonal or otherwise.* Advice means a recommendation as to a course of action.¹² In creating and administering

⁹ An investment adviser does not include a "publisher of any bona fide newspaper, news magazine or business or financial publication of general and regular circulation." Investment Advisers Act, Section 202(a)(11)(D).

¹⁰ 105 S. Ct. 2557 (1985) ("*Lowe*").

¹¹ The Court broadly interpreted the language of the exclusion. The majority construed "bona fide" to mean "genuine", in the sense of containing disinterested commentary and analysis, as opposed to self-promotional "touting". See at 2563-69. The majority further interpreted "regular" in the securities industry sense of "not timed to affect the market," rather than in the ordinary sense of "consistent periodic circulation." See at 2573. The Court intended this construction to exclude publications merely issued "from time to time" and those put out by "hit and run tipsters." See at 2571. Finally, it stressed that specific advice did not give investment advice a personalized character and that *Lowe*'s publications did not offer individual advice attuned to specific needs.

¹² For example, the Britannica Dictionary defines "advice" as "an opinion or suggestion about what someone should do." Merriam-Webster defines "advice" as a "recommendation regarding a decision or course of

indexes, index providers are clearly not recommending a course of action.¹³ Index licensees determine whether, how and for what purpose to use an index. As noted earlier, index providers express no opinion or view as to whether any market, company, strategy or investment is good or bad, or appropriate or inappropriate. Nor do they recommend or promote any investment, investment strategy or asset allocation. However, even if index providers were somehow deemed to be offering advice, it is not personalized. Customizations to underlying standard indexes are driven by clients. It would be illogical to suggest that an index provider is offering personalized advice to a client that, itself, is determining the customization. Rather, an index provider implements and calculates a customized index requested and designed by a client to more accurately reflect the strategy and constraints of its portfolio.

- (2) *The publication and dissemination of indexes are “bona fide” in that they are genuine and are not designed to provide one-off self-promotional touting.* Each index is published consistently and dispassionately according to the rules of a transparent methodology. No index is designed or intended to achieve a predetermined return; it is merely a reflection of the opportunity set that it is measuring. The licensee controls the name, investment objective, investment strategy and marketing of any fund or other product it may choose to link to an index. Index providers do not promote any funds or other securities and exercise no control over the promotion of any funds or other securities.
- (3) *The publication of an index is “regular” as that term has been interpreted by the Court.* Such publishing is not infrequent, irregular (*i.e.*, published from time to time), or designed to time the market in any way. Whether the applicable market segment is up or down, or is expected to be up or down, index providers continue to publish each index and its value on a regular and consistent basis. Stated differently, once the index provider creates and calculates an index, it continues to do so through periods of positive and negative markets (*vis-à-vis* the index’s performance).

Importantly, we note that the concurring justices in *Lowe* agreed with the Court’s majority that the person need not register as an adviser, but they based their conclusion on the right to free speech.¹⁴ Leading the concurring opinion, Justice White adopted a constitutional analysis, stating that the First Amendment to the U.S. Constitution protected the right to continue publishing investment newsletters. Justice White viewed the prohibition of the publication of investment advice as a clear restraint on speech. He acknowledged that some restraints can be permissible, but found the Investment Advisers Act, as a ban on speech in the form of newsletters containing investment advice, presumptively invalid as applied to fully protected speech. Moreover, even under the less-protected commercial speech analysis, the concurrence considered the means of regulation as too extreme and invalid.¹⁵

conduct.” The Oxford English Dictionary defines advice as: 1) “the view which a person holds in regard to a given matter; opinion, judgement, assessment”; or 2) “opinion given or offered as to what action to take.”

¹³ See *supra* p. 5.

¹⁴ See *Lowe* at 2574.

¹⁵ *Id.* at 2585-2586. See also, Robert G. Oesch, *Lowe v. SEC: Guaranteeing the Right to Publish Investment Newsletters Through Statutory Construction*, 64 Washington University Law Review 577 (1986).

Therefore, whether applying the plain language of the Investment Advisers Act, the test set forth in *Lowe* for the publisher's exclusion or a constitutional analysis, there is no basis to classify index providers as investment advisers subject to the Investment Advisers Act.

An index provider is not an "investment adviser" under the Investment Company Act of 1940

The definition of "investment adviser" that appears in Section 2(a)(20) of the Investment Company Act of 1940 (the "Investment Company Act") is similar, but not identical, to the definition in the Investment Advisers Act, and accordingly, requires a separate analysis. In pertinent part, the Investment Company Act defines an "investment adviser" of an investment company registered under the Investment Company Act (a "Fund") 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); but does not include (i) a person whose advice is furnished solely through uniform publications distributed to subscribers thereto....

With respect to clause (A), index providers do not act "pursuant to contract with [a Fund]". In the RFC, the Commission asserts that "[t]o the extent that no exception from the definition applies, the index provider could implicate the Investment Company Act's definition of investment adviser of an investment company, including when the index provider does not contract directly with a fund, but instead indirectly with the fund's investment adviser." We do not know the basis for the Commission's statement, but MSCI does not agree that the plain and clear language of a statutory definition could or should be interpreted as something other than its clear meaning.

Moreover, index providers do not provide advice to any Fund regarding the desirability of any particular investment; make any recommendation with respect to purchasing or selling securities for any investment company; provide investment advice with respect to the investment needs of a Fund; or retain any authority to purchase or sell securities for any Fund's portfolio. An index provider simply identifies the universe of securities eligible for a given index (e.g., all U.S. large cap companies) based on an index methodology, constructs the index therefrom, and calculates its value. An independent index provider's only relationship to any investment adviser to a Fund is as licensor of the provider's intellectual property. Therefore, an index provider is not an "investment adviser" under clause (A) of Section 2(a)(20).

With respect to clause (B), an index provider could only be considered an investment adviser to a Fund if it performs *substantially all* of the duties that the investment adviser to that Fund is obligated to provide under its investment management contract with the Fund. Where a Fund uses an index, the Fund's investment adviser decides which index to select, whether (and, if so, how) to customize it, and the purpose for using the index. The Fund adviser also has Fund management activities and duties for which the index provider has no role. For example:

- Active management. When an adviser implements an active management strategy, an index can serve as a performance benchmark where the adviser aims to “beat the benchmark” without any input or assistance from the index provider. The Fund’s investment adviser retains the ability to substitute other securities and assets (such as derivatives) for index constituents or to re-weight index constituents if it helps a Fund outperform the index or otherwise benefits the Fund.
- Passive management. When an adviser implements a passive management strategy, the investment adviser selects the index it seeks to track and has sole responsibility for (X) investing Fund assets in a way to track index performance (i.e., it buys and sells Fund securities and other assets and, importantly, determines exactly when and from where to buy and sell such securities and other assets) and (Y) deciding how to track the index. This may include, for example, full replication of the index constituents and weights, the use of derivative instruments, optimization or sampling, as well as setting and maintaining the degree of permitted tracking error.
- Assets under management. If the Fund is an ETF, the Fund’s investment adviser manages the Fund’s creation and redemption basket process, including the creation of custom baskets (i.e., baskets that don’t represent the index on a pro rata basis). If the Fund is a mutual fund or private fund, the investment adviser must manage the Fund in a way that the Fund maintains sufficient cash positions to meet redemption needs.
- Taxes. A Fund’s investment adviser manages the federal income tax consequences of the Fund.
- Oversight. A Fund’s investment adviser oversees a large number of other service providers to the Fund, including broker-dealers, and reports to its board of trustees/directors. A Fund’s investment adviser also manages and implements, in conjunction with the Fund’s chief compliance officer, policies and procedures designed to ensure that the Fund complies with federal and state securities laws.

An index provider does not conduct any of these activities or duties and none of the investment adviser’s activities or duties are delegated to index providers. Nevertheless, even if an index provider were somehow determined to be an “investment adviser” to a Fund under Section 2(a)(20) of the Investment Company Act, an index provider should be able to avail itself of the related “publisher’s exclusion,” which exempts “a person whose advice is furnished solely through uniform publications distributed to subscribers thereto.” Each MSCI index is “uniform” in that it is the same at any given time for all parties who access it. Indexes are “publications” and “distributed to subscribers” in that the indexes and methodologies are made widely available to subscribers and also through third party vendors such as via Bloomberg or FactSet.

Additionally, although *Lowe* was not applied to the publisher’s exclusion embedded in the Investment Company Act’s definition of “investment adviser,” the *Lowe* analysis in our discussion under the Investment Advisers Act above should equally lead to a finding that an index provider is not an “investment adviser” under the Investment Company Act.

Classifying Index providers as investment providers is inconsistent with precedent

Congress had an opportunity to include index providers within the definition of “investment adviser” under the Investment Advisers Act and the Investment Company Act and has

elected not to do so.¹⁶ Congress similarly had opportunities to consider the role of index providers over a number of years since the passing of the Investment Advisers Act and the Investment Company Act and has, at no stage, seen the need to clarify or intervene to include index providers as investment advisers under either statute.

In addition, the Commission has had numerous opportunities to state that index providers act as unregistered investment advisers and previously has elected not to do so. The implicit position that index providers have not been treated as advisers can be traced back at least to the first ETF, the SPDR Trust, which is organized as a unit investment trust. Unit investment trusts are unmanaged investment vehicles and therefore do not (and cannot) have investment advisers. If an index provider were to be treated as an investment adviser, the SPDR Trust (as well as many other ETFs organized as unit investment trusts) could be managed investment vehicles contrary to the definition of “unit investment trust.”

Furthermore, in the context of exemptive relief ordered by the Commission with respect to affiliated index providers to ETFs, an index provider affiliated with the investment adviser to an ETF was specifically not treated as an investment adviser, notwithstanding the fact that the index provider designed indexes for certain related funds. We also highlight that the Commission has permitted, and continues to permit, self-indexed ETFs (*i.e.*, indexes created and calculated by a non-investment adviser division of a sponsor) to be treated under the same rules as other indexed ETFs. In doing so, the Commission did not suggest that the unregulated entity’s provision of a “single use” index to a self-indexing fund, or any other scenario involving single use or broad-based index licensing, might be investment advice, which would have been highly relevant to its detailed legal and regulatory analysis. Instead, the Commission broadly rejected the need to impose any additional regulatory requirements or conditions, such as to address conflicts of interest between an index provider and its affiliated, regulated ETF, due to what it viewed as adequate existing requirements under federal securities laws.¹⁷

Current industry practice and prior exemptive orders issued by the Commission stand for the proposition that index providers are not investment advisers to funds. Fund boards, for example, are not required to approve contracts with index providers as if they were investment advisers. Reversing those practices would be inconsistent with historical views and long-established precedent and practice, and not only would raise questions about the validity of index provider contracts (given that none are, or have ever been, approved under

¹⁶ Financial indexes were well known to the drafters of the Investment Advisers Act and the Investment Company Act. The Dow Jones Transportation Average inceptioned in 1884 and the Dow Jones Industrial Average inceptioned in 1896. In 1923, Standard Statistics Company developed its first stock market index consisting of the stocks of 233 U.S. companies, computed weekly. See also, Pierre-Cyrille Hautcoeur, *The Early History of Stock Market Indices, with Special Reference to the French Case* (a preliminary paper); available at https://www.parisschoolofeconomics.com/hautcoeur-pierre-cyrille/Indices_anciens.pdf

¹⁷ Exchange-Traded Funds, Release Nos. 33-10695; IC-33646 (December 23, 2019) (“Rule 6c-11 Adopting Release”) at FN 64 and accompanying text. See also Rule 6c-11 Adopting Release at page 25 (footnotes omitted from text):

We agree with the commenters who stated that the existing federal securities laws adequately address any special concerns that self-indexed ETFs present, including the potential ability of an affiliated index provider to manipulate an underlying index to the benefit or detriment of a self-indexed ETF. For example, ETF sponsors are likely to be in a position to understand the potential circumstances and relationships that could give rise to the misuse of non-public information, and can develop appropriate measures to address them. Therefore, we continue to believe that portfolio transparency combined with existing requirements should be sufficient to protect against the abuses addressed in exemptive applications of ETF sponsors that either use affiliated index providers or create their own indexes.

Section 15(c) of the Investment Company Act), but also would have significant, wide and complicated ramifications for the entire fund industry.

2. **Classifying index providers as advisers would introduce confusion and conflicts of interest and impede the strength of U.S. capital markets**

Misclassifying index providers as investment advisers under the Investment Advisers Act or the Investment Company Act would have a number of unintended consequences that would be damaging for the capital markets. In particular:

- (i) *The duties of an index provider with respect to a securities index that it offers globally would be contradictory and harmful to the competitiveness of U.S. capital markets.* An index provider could be responsible for a globally-used index in the U.S. as an investment adviser with fiduciary duties owed to its clients. For the same index, the provider could also be subject to the United Kingdom (“UK”) and the European Union (“EU”) regulatory frameworks as a benchmark administrator with the duty to maintain independence in administering the index according to its methodology *without* taking into consideration the needs of any particular customers.¹⁸ The fiduciary duty of an adviser is at odds with the independence duty of a regulated benchmark administrator.
- (ii) *Confusion as to who will be deemed to receive “the advice”.* The identity of the index provider’s client could depend on whether the index provider would be deemed an “investment adviser” under either, or both, the Investment Advisers Act and Investment Company Act. In the context of registered investment companies, if the provider is only deemed an “investment adviser” under the Investment Advisers Act (and not the Investment Company Act) the index provider’s client is likely to be the investment adviser to a registered investment company, but not to the registered investment company itself. If the index provider is also deemed an “investment adviser” under the Investment Company Act (which is a somewhat higher definitional hurdle), its client is likely to be the registered investment company, although it has no contract with the Fund. In other contexts (for example, using the index as a benchmark or an underlying reference in a derivative transaction), the index provider may find its client to be another adviser, a broker-dealer or a bank. If the Commission were to deem an index provider to be an investment adviser, a clearly defined and objective standard for identifying the index provider’s client would be critically important so that, among other things, the index provider could ascertain whether it might have conflicts of interest among its clients, and whether it could properly discharge its fiduciary duty.
- (iii) *Duty of care will introduce new conflicts of interest.* As an independent index provider, and as a UK Financial Conduct Authority (“FCA”)-registered benchmark administrator, MSCI administers its indexes in an objective manner by applying a rules-based approach. The potential impact (positive or negative) on a licensee of an index administration action, such as an index re-balancing or establishing a liquidity threshold for index inclusion, is currently not considered in the context of a fiduciary duty owed by the index provider. However, if the index provider were deemed to owe a fiduciary duty to a licensee (or other entity), it would need to act in that licensee’s best interests. This obligation would remove an index

¹⁸ See fn 7 above.

provider's ability to be objective and independent, which is a necessity whenever there are multiple licensees to a particular index, each with different, potentially competing interests, objectives and use cases. The fiduciary obligation could require that every index be personalized for every client, which is impractical and impossible. Further, index providers do not have the expertise or information to determine whether an index is suitable for a client. Should it be the role of an index provider to determine, for example, whether it is suitable for a particular client to license an Emerging Markets Index or a German Automobiles Index? That is the role of an investment adviser, not a data or information provider. The likely paralysis in index administration would cause widespread disruption to the capital markets and indexed investments.

- (iv) *Shifting of responsibility.* Currently, index providers limit their liability, which is typical of market data or other similar information providers. In return, licensees pay relatively low license fees to use the index. To the extent that an index provider is deemed an investment adviser, index providers would need to significantly increase their licensing fees to compensate for the additional liability of being a fiduciary. These increased fees would likely be passed on to end investors by the investment advisers who license indexes and manage indexed funds, undermining the benefits of indexed investments that have "democratized" investing by allowing a broader universe of investors to access the capital markets at low cost.
- (v) *Increase in litigation could lead to a catastrophic collapse of the industry or "death by a thousand cuts."* To the extent an index provider is deemed an "investment adviser" under the Investment Company Act, plaintiffs could be expected to seek new and creative ways to bring lawsuits against index providers. Defending the lawsuits alone would impose significant costs and burdens on index providers that ultimately would be passed to investors. Furthermore, Section 36(b) of the Investment Company Act imposes a fiduciary duty on investment advisers with respect to the compensation they receive for providing advisory services to registered investment companies, and it provides fund shareholders with an express private right of action to enforce this duty. In 2010, the U.S. Supreme Court, in *Jones v. Harris Associates L.P.*, affirmed the use of the "Gartenberg standard" for assessing the liability of fund advisers in excessive fee cases brought under Section 36(b). While providing greater clarity to Section 36(b) jurisprudence, the *Jones* decision did not discourage the plaintiffs' bar from initiating new section 36(b) lawsuits. We would expect plaintiffs to use section 36 of the Investment Company Act as a further basis for litigation.
- (vi) *Indexes treated differently from a regulatory perspective depending on the use case.* It seems unlikely that an index used in the construction of, or referenced as, a benchmark in a futures contract on a broad-based securities index would fall under the securities regulatory framework because these products are regulated by the Commodity Futures Trading Commission ("CFTC"). However, when the same index is used in the construction of an ETF, it would fall under the regulatory framework administered by the Commission. This is likely to cause significant confusion in the markets.

3. There is already an existing framework under the IOSCO principles to address investor protection concerns

MSCI has committed to high standards in benchmark administration as evidenced through our long history as a respected index administrator and our adoption of the IOSCO Principles. Further, on 5 March 2018, MSCI Limited was granted authorization by the FCA as a UK benchmark administrator.¹⁹

Other than providing a broad introductory overview, the RFC does not set out why the operations of index providers necessitate a fundamental change to the current U.S. securities regulatory framework. Instead, the RFC appears to propose an impracticable solution in search of a problem, and it does so largely by asserting academic arguments as to whether the definitions under the Investment Advisers Act and Investment Companies Act cover index providers.

To the extent there are questions around index governance, transparency and conflicts of interest, these issues are at the core of the IOSCO Principles and reflect global consensus on how these should be addressed. The IOSCO Principles were published in 2013 to promote the reliability of benchmark administration, and address benchmark governance, quality and accountability mechanisms. In particular, the principles cover:

- *Governance* - A benchmark is required to have appropriate governance arrangements to protect the integrity of the benchmark and to address conflicts of interests.
- *Quality of benchmarks* – A benchmark should be an accurate and reliable representation of the economic realities of the interest it seeks to measure and eliminate factors that might result in a distortion of the price, rate, index or value of the benchmark. This should include sufficient transparency regarding the development of the benchmark.
- *Quality of methodology* – The methodology for each benchmark should be published and provide sufficient detail to allow users to understand how the benchmark is derived and to assess its representativeness, and its appropriateness as a reference for financial instruments.

IOSCO also recognized potential conflicts of interest in administering an index when launching its Principles:

“Specifically, the IOSCO Board seeks to articulate policy guidance and principles for Benchmark-related activities that will address conflicts of interest in the Benchmark-setting process, as well as transparency and openness when considering issues related to transition.”²⁰

IOSCO noted that “[t]he final Principles have been developed, and should be read collectively, to address these vulnerabilities”²¹ and “[t]o protect **the integrity and independence of Benchmark determinations**, Administrators should document, implement and enforce policies and procedures for the identification, disclosure, management, mitigation or avoidance of conflicts of interest.”²² It is unclear what has changed since the publication of the IOSCO Principles to prompt additional action by the Commission.

¹⁹ The EU BMR is currently under review by the EU Commission. Given the ongoing uncertainty of the scope of the EU BMR, we would caution about this being used as the model for any regulatory intervention.

²⁰ IOSCO Principles, page 3.

²¹ *Id.* at page 4.

²² *Id.* at page 16.

The IOSCO Principles have served index users well because they recognize index providers as a distinct market segment with bespoke principles of conduct relevant to index construction and maintenance. It follows that in jurisdictions where indexes are regulated, legislatures have developed bespoke legislation based on the IOSCO framework and have not classified index providers as investment advisers.²³ If investment advice were deemed to be such an integral function, or even a possible function, of an index provider, IOSCO, the industry, and indeed legislators and regulators, would have included this in their principles, codes, regulations or guidelines. Indeed, as previously discussed, both Congress and the Commission have consistently declined to classify index providers as investment advisers. To do so now would not only be a departure from precedent but would also position the U.S. as an outlier from global standards.

We appreciate the concern of the Commission that the IOSCO Principles are voluntary and regulatory enforcement against the Principles is limited. In light of this concern, an alternative, practical and proportionate solution for the Commission to consider would be to require registered investment advisers or funds to ensure that the indexes they use are administered by index providers that have adopted, and abide by, the IOSCO Principles.

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MSCI would like to thank the Commission for its consideration of MSCI's submission. Should you have any questions, please do not hesitate to contact me through [REDACTED] at your convenience.

Yours faithfully,

/s
Neil Acres
Managing Director and Global Head of Government and Regulatory Affairs
MSCI Inc.

²³ For example, EU, UK, South Africa and Australia.