August 16, 2022

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

Re: Request for Comment on Certain Information Providers Acting as Investment Advisers; File Number S7-18-22; RIN 3235-AM95; 87 Fed. Reg. 37,254 (June 22, 2022)

Dear Ms. Countryman:

Better Markets[1] appreciates the opportunity to comment on the above-captioned Request for Comment ("Request" or "RFC"). The Request seeks input on certain types of information providers, including index providers, and whether their activities may cause them to meet the definition of an "investment adviser," requiring their registration and regulation as advisers under the federal securities laws.

The short answer is that many information providers clearly appear to be acting as investment advisers and should be regulated as such. It is without question appropriate to closely examine the issue and to solicit input, especially given the growth in the number and influence of indexes in today's markets. Ultimately, we would expect the SEC to develop reforms that will increase transparency, protect investors from the conflicts of interest and other threats inherent in the information provider business model; promote fair competition among all those who act as investment advisers by regulating them similarly; and protect the overall integrity of the securities markets.

OVERVIEW OF REQUEST

The Request seeks public comment on three types of information providers:

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[1] Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system that protects and promotes Americans' jobs, savings, retirements, and more.

- Index providers, which generally compile, create methodologies for, sponsor, and administer market indexes, which in turn are licensed for use as performance benchmarks by active managers or as the basis for funds that track the index;

- Model portfolio providers, which generally design portfolios comprised of a group of diversified assets intended to achieve a particular return with exposure to corresponding risks. These information providers are generally compensated through fees on the securities bought, sold, and held in the model portfolio, although some charge separate fees for use of the portfolio or commissions or other transaction-based compensation.

- Pricing services, which generally provide prices, valuations, and additional data about specific investments to assist users in determining an appropriate value for an investment, including in cases where market quotations for an investment are unavailable or where complete information is unavailable because the security is traded in the over-the-counter market.

These information providers share certain attributes and raise a number of common concerns. They exercise a considerable degree of discretion and judgment in their work. For example, index providers typically determine or select the market or sector the index will measure, the constituent securities that make up the index, the weightings they receive, and other aspects of the methodology governing the index. In addition, index providers typically have the ability to make changes to the index, including its constituent securities over time. While some index providers have historically been associated with passive investing strategies, others design specialized indexes that are personalized for a particular user and require the provider to make highly tailored decisions in designing or administering the index. Similarly, model portfolio providers consider the characteristics and goals of a particular client type as they design a portfolio and sometimes will engage in a more detailed, customized analysis in light of a client's specific goals.

Information providers have a significant impact on the securities markets in a number of important ways. They influence not just the provider's clients but also other investors and the markets more widely. For example, as noted in the Request, whether or not an index is specialized, the provider's decision to include a particular security in an index will often induce advisers with clients tracking and relying on that index to purchase or sell securities in response.[2]

Information providers also raise investor protection concerns. For example, as the Request explains,[3] providers have advance knowledge of forthcoming changes to the information they generate and therefore are positioned to engage in front-running. In addition, they may have strong conflicts of interest if they themselves hold investments that are constituents of the indexes or model portfolios they create or are the subject of the valuation services they provide.

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2 Request at 37,255.
3 Request at 37,254.

The impact of information providers on investors and the markets more generally is increasing as they proliferate and become more widely used. The number and variety of indexes has grown steadily over time, resulting in millions of indexes having been created in the global markets according to data cited in the Request.[4] Funds that track indexes have grown substantially in recent years, to include over $10 trillion in assets under management. Indexes are also increasing in the ESG realm, an area of mounting concern as greenwashing and other abuses have become more prevalent. And as noted in the Request, providers, as they increase in size and scope, are increasingly likely to affect national markets or to have a "national presence."[5]

In light of all of these considerations—the nature of the work that information providers perform, the risks they present, and their increasingly broad impact on investors and the securities markets—it is certainly appropriate for the Commission to revisit the regulatory treatment of this cadre of market participants, including specifically whether the SEC should regard them as investment advisers who should be subject to the same requirements that are applicable to others who perform fundamentally the same functions.

COMMENTS

I. Treating Information Providers as Investment Advisers Appears To Be Well-Justified on Legal and Policy Grounds.

A. Even a cursory legal analysis supports the investment adviser status of many providers.

The primary focus of the Request is whether by virtue of their activities, providers fall within the definition of an investment adviser ("IA") under the Investment Advisers Act ("IAA") or the Investment Company Act ("ICA"). The IAA 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;[6]

The Request distills this definition into three components:

> The definition generally includes three elements for determining whether a person is an investment adviser: (i) the person provides advice, or issues analyses or reports, concerning securities; (ii) the person is in the business of providing such services; and (iii) the person provides such services for compensation.[7]

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[4] Request at 37,255.
[5] Request at 37,254.
[6] 15 U.S.C. § 80b-2(11).
[7] Request at 37,256.

The Request further observes, in keeping with judicial pronouncements that the definition should be interpreted broadly, that these elements are expansive: Advice need not pertain to specific securities; giving advice need not constitute the principal business activity of the person; and the receipt of any economic benefit, whether advisory fees, commissions, or other forms of compensation, suffices for purposes of the compensation element.[8]

This legal overview suggests that providers, at least many of them, are indeed acting as investment advisers and should be required to comply with the IAA and as appropriate, the ICA. All three types of providers, including the more specialized or "special purpose" index providers, clearly appear to be engaged "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 the words of some scholarship on the subject, many providers are in effect "selecting securities for a particular client to meet that client's individualized needs,"[9] activities well within the ambit of the statutory definition of an investment adviser. They are in short "responsible for directing trillions of dollars' worth of investments."[10]

Moreover, it appears that the publisher's exclusion would not apply to many providers. That exclusion carves out from the IA definition "the publisher of any bona fide newspaper, news magazine or business or financial publication of general and regular circulation."[11] Based on the wording of the exclusion and the judicial interpretations of its elements,[12] many providers would be hard-pressed to invoke it, since in many cases they are providing personalized advice about the value of securities or providing analyses or reports in response to their clients' requests and needs, rather than disseminating purely disinterested or impersonal advice through a publication of general circulation.

B. The policy justification is strong.

The benefits of applying IA regulation to providers are clear. Investment advisers are required to register with the Commission, submit to exams, and make extensive disclosures via the Form ADV. In addition, and among the greatest benefits of IA regulation, IAs are subject to the fiduciary duty requiring, at least in theory, that they adhere to the highest standards of care and loyalty to their clients, especially regarding the disclosure and management of conflicts of interest. And, of course, they are subject to the Commission's enforcement authority for violations of the statutory provisions and rules applicable to IAs. All of these regulatory safeguards together help

8 Request at 37,256-7.
9 Paul G. Mahoney & Adriana Z. Robertson, *Advisers by Another Name*, University of Virginia School of Law, Law and Economics Paper Series 2021-01, at 3 (Jan. 2021).
10 Statement on Request for Comment on Certain Information Providers Acting as Investment Advisers, SEC Commissioner Caroline A. Crenshaw (June 15, 2022), https://www.sec.gov/news/statement/crenshaw-statement-request-comment-certain-information-providers-061522.
11 15 U.S.C. § 80b-2(11)(D).
12 *See* Request at 37,257 (discussing *Lowe v. SEC,* 472 U.S. 181 (1985) and *SEC v. Park,* 99 F. Supp. 2d 889 (N.D. Ill. 2000)).

ensure that IAs are fair and transparent in their dealings and accountable for violations of applicable law.

We also note that requiring providers to adhere to the IA regulatory framework promotes fundamental fairness. It is axiomatic that similar activities in the financial markets should be treated similarly from a regulatory standpoint. Apart from serving the interests of fundamental fairness, this even-handed approach also promotes the three economic factors that the SEC is required to consider in its rulemaking process: efficiency, competition, and capital formation—especially fair competition.

Better Market has advocated in support of this basic principle of regulation in other contexts, and the SEC has to its credit relied upon it in developing other recent regulatory reforms. For example, the Commission has proposed to ensure that alternative trading systems ("ATSs") that trade government securities are required to comply with Regulation ATS just as other trading platforms must, thus removing a carve-out in securities regulation that weakens investor protection, market integrity, and fair competition.[13] In the same proposal, the Commission has also sought to ensure that Communication Protocol Systems, which fall under the statutory definition of an exchange, are regulated as such, either by registering as an exchange or by complying with Regulation ATS. As the Commission found, Communication Protocol Systems are clearly performing the same core market functions that exchanges and ATSs perform, notwithstanding the "variations" in platform design.[14] As the Commission further observed, regulatory disparities between market participants "can create a competitive imbalance and a lack of investor protections."[15] The same is true with respect to investment advisers acting through the information provider "platforms." And in yet another recent proposal, the Commission has sought, by refining the meaning of the phrase "as part of a regular business," to require market participants, including high-frequency trading firms providing liquidity, to register as dealers or government securities dealers if they are conducting dealer-like activities.[16]

Finally, and in a related vein, application of the IA regime to information providers aligns with some of the most basic tenets of securities laws as interpreted by the Supreme Court. The Court has repeatedly explained that what counts in determining whether the securities laws apply are not the labels and formalities accompanying an investment offering or activity but the

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13 *See* Amendments to Exchange Act Rule 3b-16 Regarding the Definition of "Exchange"; Regulation ATS for ATSs That Trade U.S. Government Securities, NMS Stocks, and Other Securities; Regulation SCI for ATSs That Trade U.S. Treasury Securities and Agency Securities (File No. S7-02-22, RIN 3235-AM45), 87 Fed. Reg. 15,496 (Mar. 18, 2022); *see also* Better Markets comment letter on the Regulation ATS proposal (Apr. 18, 2022), https://bettermarkets.org/wp-content/uploads/2022/04/Better_Markets_Comment_Letter_Reg_ATS.pdf.

14 ATS Release at 15,498.

15 ATS Release at 15,498.

16 *See* Further Definition of "As a Part of a Regular Business" in the Definition of Dealer and Government Securities Dealer (File No. S7-12-22, RIN 3235-AN10), 87 Fed. Reg. 23,054 (Apr. 18, 2022); *see also* Better Markets comment letter on the dealer registration proposal (May 27, 2022), https://bettermarkets.org/impact/better-markets-supports-sec-rules-to-expand-regulation-on-high-frequency-trading-firms/.

economic realities underlying the product or behavior at issue. Only with this interpretive approach can the securities laws fully achieve their remedial purposes and adapt to the constantly evolving nature of the financial markets.[17]

II. <u>The Commission Should Be Skeptical of Industry's Expected Opposition Based on Supposedly Adverse Consequences or Its Insistence on Quantitative Cost-Benefit Analysis.</u>

A. <u>The Commission should not be swayed by dire industry predictions surrounding the treatment of providers as IAs.</u>

To the extent the Commission moves forward with a rule proposal that brings information providers within the ambit of investment adviser regulation, it should bear in mind a number of guiding principles. Foremost among them is the need to closely scrutinize and discount industry's often overstated forecasts of the adverse consequences of regulation. Here, we already see signs of a strong push back from an industry that is deploying this strategy. One commentary on the Request offers a litany of ominous predictions, to the effect that it would: impose new and significant costs and burdens on providers, which may be passed on to customers and investors; reduce investment product and advisory service offerings to investors if costs cannot be shifted; result in the closure of some funds or other investment products; impose barriers to entry to new potential information providers; and reduce the sophistication and future innovation in investment strategies available to retail investors if financial index or model construction is required to be simplified in order to avoid regulation by the SEC as an investment adviser.[18]

The response at this juncture is two-fold. First, such claims must be rejected unless they ultimately can be substantiated with credible, objective, and persuasive facts and arguments, beyond mere speculation. Second, these claims should also be viewed against Wall Street's long history of inflating concerns about the impact of regulation—regulation that ultimately has allowed the financial services industry to become and remain among the most profitable enterprises in human history.

In fact, such dire predictions are precisely the type of sky is falling exaggerations that the financial services industry has launched against new regulation for almost a century. Time and time again, they have ominously warned that new regulatory requirements will have a devastating impact by imposing unbearable compliance costs. Yet Wall Street has absorbed those reforms and continued to prosper. For example, a century ago, when securities regulation first emerged at the state level, Wall Street railed against it as an "unwarranted" and "revolutionary" attack upon

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17 *See SEC v. W.J. Howey Co.*, 328 U.S. 293, 299 (1946); *see also Tcherepnin v. Knight*, 389 U.S. 332, 336 (1967).

18 *See* Nicholas Ersoy, Richard Kerr, Peter Shea, and Trayne Wheeler, *SEC Solicits Comments on Whether Index Providers, Model Portfolio Providers, and Pricing Services Are Investment Advisors: Seeking a Problem for a "Solution,"* K&L Gates LLP, https://www.jdsupra.com/legalnews/sec-solicits-comments-on-whether-index-1898288/ (July 5, 2022).

legitimate business that would cause nothing but harm.[19] However, in the years following this early appearance of financial regulation, banks and their profits grew handsomely.[20]

Subsequently, when the federal securities laws were adopted, Wall Street staunchly opposed them, claiming that they would slow economic recovery by impeding the capital formation process and discouraging the issuance of new securities. In fact, in the years after the enactment of the federal securities laws, the nation's securities markets flourished. The same pattern has been repeated with each new effort to strengthen financial regulation, including deposit insurance, the Glass-Steagall Act, mutual fund reform, and the national market initiatives of the mid-1970s.[21]

More recently, the mortgage lending industry fiercely opposed new mortgage underwriting standards to be administered by the Consumer Financial Protection Bureau. The lending industry hysterically predicted that the new rules would "cripple credit availability and spur banks, credit unions, and mortgage lenders to ***quit the business entirely*.**"[22] However, the available data show that this simply did not happen and that in fact, lending activity increased.[23] The lesson to be learned from this history is that when faced with new regulations, members of the regulated industry routinely argue that the costs and burdens are too heavy—but then they invariably adapt and thrive.

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19 *See* Marcus Baram, *The Bankers Who Cried Wolf: Wall Street's History of Hyperbole About Regulation*, THE HUFFINGTON POST (Jun. 21, 2011, 6:56 PM), http://www.huffingtonpost.com/2011/06/21/wall-street-historyhyperbole-regulation_n_881775.html.

20 *See* Paul G. Mahoney, *The Origins of the Blue-Sky Laws: A Test of Competing Hypotheses*, 46 J.L. & ECON. 229, 249 (2003) ("In the 5 years following adoption of a merit review statute [the most stringent type of blue sky law statute], bank profits increased on average by nearly 5 percentage points . . .").

21 Marcus Baram, *supra* note 19; *see also* Nicholas Economides et al., *The Political Economy of Branching Restrictions and Deposit Insurance: A Model of Monopolistic Competition Among Small and Large Banks*, 39 J. L. & ECON. 667, 698 (1996) ("The American Bankers Association fights to the last ditch deposit guarantee provisions of Glass-Steagall Bill as unsound, unscientific, unjust and dangerous. Overwhelmingly, opinion of experienced bankers is emphatically opposed to deposit guarantee which compels strong and well-managed banks to pay losses of the weak . . .The guarantee of bank deposits has been tried in a number of states and resulted invariably in confusion and disaster . . . and would drive the stronger banks from the Federal Reserve System.") (quoting Francis H. Sisson, president of the American Bankers Association).

22 John Heltman, *Mortgage Rules Not Chilling Market as Feared, Data Shows,* American Banker (Sep. 24, 2015), http://www.americanbanker.com/news/law-regulation/mortgage-rules-not-chilling-market-as-feared-data-shows-1076899-1.html (emphasis added).

23 *Id.*

B. Reject calls for a rigorous and quantitative cost-benefit analysis.

Industry opponents of SEC rules frequently claim that they fail a cost-benefit test, and specifically that they will prove too costly. Any rule proposal following the Request will likely be subject to these attacks. As a general matter, however, these arguments are unfounded, both legally and factually. They distort the Commission's legal obligation to conduct economic analysis; they exaggerate the alleged costs and burdens of compliance with the new rules; and they downplay if not ignore the enormous benefits that the rules will confer, both individually and as part of a collection of rules that will work together to achieve market reforms. But this strategy should not sway the Commission or persuade it to dilute any reforms it deems necessary and appropriate to protect investors and the integrity of the markets. Throughout the rulemaking process, the Commission must be guided above all by the public interest and the protection of investors as it considers the economic impact of its rules, not by concerns over the costs of regulation imposed on industry.

As we have explained,[24] under the securities laws, the Commission has no statutory duty to conduct cost-benefit analysis. In reality, it's far more limited obligation is simply to consider, "***in addition to the protection of investors***, whether the action will promote efficiency, competition, and capital formation."[25] The Supreme Court has long recognized that statutorily mandated ***considerations*** "imply wide areas of judgment and therefore of discretion" as an agency fulfills its statutory duty.[26]

Nevertheless, the SEC also voluntarily undertakes its customary assessment of the potential costs and benefits of its rule proposals. Often, it confronts and identifies insurmountable challenges involved in cost-benefit analysis, explaining that many of the benefits and costs are "difficult to quantify" and observing that the data needed to quantify these economic effects "are not currently available and the Commission does not have information or data that would allow such quantification."[27] The Commission's evaluation of costs and benefits therefore

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24 For example, in 2012, we issued a report examining and exposing the largely successful attempt to foist more stringent cost-benefit analysis requirements upon the SEC, even though the securities laws include no such mandate. *See, e.g.,* BETTER MARKETS, SETTING THE RECORD STRAIGHT ON COST-BENEFIT ANALYSIS AND FINANCIAL REFORM AT THE SEC (July 30, 2012), https://bettermarkets.com/sites/default/files/Setting%20The%20Record%20Straight.pdf. In addition, we have updated the report; BETTER MARKETS, COST-BENEFIT ANALYSIS IN CONSUMER AND INVESTOR PROTECTION REGULATION: AN OVERVIEW AND UPDATE (Dec. 8, 2020), https://bettermarkets.com/sites/default/files/Better_Markets_WhitePaper_CBA_Consumer_Investor_Investor_Protection_Dec-2020.pdf . We incorporate those two reports by reference as if fully set forth herein.

25 *See* 15 U.S.C. § 77b(b) (emphasis added); 78 U.S.C. § 78c(f); 15 U.S.C. § 80a-2(c); 15 U.S.C. § 80b-2(c).

26 *Sec'y of Agric. v. Cent. Roig Ref. Co.,* 338 U.S. 604, 611 (1950).

27 *See, e.g.,* Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices (File No. S7-17-22, RIN 3235-AM96), 87 Fed. Reg. 36,654; 36,698 (June 17, 2022).

understandably and inevitably turns largely to a qualitative discussion of the economic effects of a proposal.[28] All of that should come as no surprise. The Commission's rules are designed primarily to protect investors and maintain the integrity of the markets, while at the same time taking into account efficiency, competition, and capital formation. But it is difficult to even attempt to begin placing precise dollar amounts on such benefits. How do you quantify the monetary, let alone non-monetary benefits, to investors of preventing fraud and conflicts of interest or enhancing the quality and quantity of information available to them?

These are appropriate observations about the inevitable difficulties surrounding attempts at quantitative cost-benefit analysis; they are not failings of the Commission that suggest any legal infirmities in the proposals. As the D.C. Circuit has explained, in *Nat'l Ass'n of Mfrs. v. SEC*,[29] "An agency is not required to measure the immeasurable, and need not conduct a rigorous, quantitative economic analysis unless the statute explicitly directs it to do so"—a burden that Congress never saw fit to impose on the Commission.

Indeed, Better Markets has consistently argued that quantitative cost-benefit analysis is, for a host of reasons, a poor methodology for evaluating financial regulation: It is unreliable, speculative, and biased in favor of industry's relentless concerns with minimizing compliance costs while maximizing profits. Moreover, it consumes far more in agency resources than it is worth and ultimately sets the stage for a court challenge instigated by the disgruntled members of industry.[30]

The rationale for Congress's decision to impose only a flexible obligation to consider three discrete economic factors is clear: requiring the Commission to conduct a resource-intensive, time consuming, and inevitably imprecise cost-benefit analysis as a precondition to rulemaking would significantly impair the agency's ability to implement Congress's regulatory objectives. The industry's desire to have its costs prioritized over all other costs (what they falsely refer to as "cost-benefit analysis") does not change the securities laws, the reasoned basis for those laws, or the underlying policies. The Commission was established for the purpose of implementing the securities laws, and its primary duty is to achieve the legislative objectives of those laws: protecting investors and the public interest.[31]

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28 *Id.* 36,698.

29 748 F. 3d 359 (D.C. Cir. 2014).

30 *See, e.g.,* Better Markets, Cost-Benefit Analysis in Consumer and Investor Protection Regulation: An Overview and Update (Dec. 8, 2020), https://bettermarkets.org/sites/default/files/Better_Markets_WhitePaper_CBA_Consumer_Investor_Investor_Protection_Dec-2020.pdf=; Better Markets, Setting the Record Straight on Cost-Benefit Analysis and Financial Reform at the SEC (July 30, 2012), https://bettermarkets.com/sites/default/files/Setting%20The%20Record%20Straight.pdf.

31 The SEC should routinely make clear that while it is considering the costs and benefits as part of the rulemaking process, it is not doing so pursuant to its interpretation of any statutory requirements. Otherwise, the rule may be struck down for failure to "properly" conduct a quantitative cost-benefit analysis, although none is explicitly required by statute. *See, e.g., Am. Equity Inv. Life Ins. Co.*, 613 F.3d 166, 177 (D.C. Cir. 2010).

CONCLUSION

We hope these comments are helpful as the Commission continues to analyze the regulatory status of information providers.

Sincerely,

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