June 21, 2022

SEC Issues Request for Comment on Regulatory Status of "Certain Information Providers" Under the Investment Advisers Act

The Request for Comment Focuses on Whether Activities of Index Providers, Model Portfolio Providers and Pricing Services May Cause Them to be Within the Definition of "Investment Adviser"

SUMMARY

On June 15, 2022, the Securities and Exchange Commission (the "SEC") issued a request for information and public comment (the "Request for Comment") on matters related to the activities of index providers, model portfolio providers and pricing services (referred to by the SEC as "information providers" or "providers"). The SEC states that the role of such firms "has grown in size and scope in recent years, significantly changing the face of the asset management industry," that "[t]he development and nature of these services may raise investment adviser status issues" under the Investment Advisers Act of 1940 (the "Advisers Act") and that comments are requested "to facilitate consideration of whether regulatory action is necessary and appropriate to further the [SEC's] mission."[1]

The Request for Comment asks 40 questions with a total of 145 subparts. Consistent with Chairman Gensler's approach on several other recent initiatives, the comment deadline is accelerated, with comments due on August 16, 2022 or 30 days after the Request for Comment is published in the Federal Register, whichever is later.[2]

The implications of the Request for Comment could be significant for index providers, model portfolio providers and pricing services that currently take the position that their activities do not subject them to

registration or regulation under the Advisers Act. Any potential regulatory action following the Request for Comment would likely impose significant costs on firms that provide these services and may impose limitations on their operations.

OVERVIEW OF THE REQUEST FOR COMMENT

The Request for Comment is primarily focused on the regulatory status of three categories of information providers: index providers, model portfolio providers and pricing services. Index providers compile, create the methodology for, sponsor, administer and license market indexes. Model portfolio providers create model portfolios generally consisting of diversified groups of assets (often mutual funds or exchange-traded funds) designed to achieve a particular expected return with exposure to corresponding risks. Pricing services provide prices, valuations and additional data about particular investments to assist users with determining appropriate values.

Focusing on the growth of the role of these information providers in the asset management industry in recent years in terms of both size and scope,[3] the discretion they exercise and potential investor protection and market concerns, including front-running of trades and conflicts where the providers or their personnel hold investments they value or that are constituents of their indexes or models, the SEC asks a number of questions related to their regulatory status under the Advisers Act.[4] The Request for Comment includes detailed and pointed questions such as how providers analyze whether they meet the Advisers Act's definition of "investment adviser," including whether they rely on the "publisher's exclusion,"[5] whether the regulatory status of providers developing broad-based indexes should differ from those developing customized or bespoke indexes, to what extent providers view themselves as having fiduciary obligations to any investors that rely on the information they provide (for example, when investors receive such information through another financial professional), how providers address potential conflicts of interest, the extent of existing disclosure regarding information provider relationships provided to investors and the SEC, whether there should be an exemption from the prohibition against registration for providers that do not have regulatory assets under management but that have a "national presence" or can have a significant effect on the national markets, and whether any U.S. regulatory action should be aligned with the framework for index providers under the EU Benchmarks Regulation.[6]

Investment advisers required to be registered with the SEC are subject to substantive prohibitions and requirements including contractual requirements, recordkeeping obligations and oversight by the SEC, including periodic filings and inspection. All advisers, including unregistered advisers, are subject to the Advisers Act's antifraud provisions. Notably, the Request for Comment suggests that it is possible to tailor the adviser regulatory regime (including reporting requirements) to different types of investment advisers.[7]

The Request for Comment also suggests certain providers may implicate provisions relating to investment advisers of investment companies under the Investment Company Act of 1940 (the "Investment Company

Act"). For example, the Request for Comment states that an index provider, particularly to the extent the index provider maintains a bespoke index created for a single fund, could meet the definition of an investment adviser to a fund under the Investment Company Act. Such status would trigger significant requirements, obligations and limitations, including requirements for fund board and shareholder approval of the investment adviser's advisory contract, as well as prohibitions on self dealing and other types of overreaching of a fund by its affiliates (including its investment adviser(s)), and requirements related to the approval of compliance policies and procedures by the fund's board.

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ENDNOTES

[1] *See* Request for Comment on Certain Information Providers Acting as Investment Advisers, SEC Release No. IA-6050 (June 15, 2022), *available at* https://www.sec.gov/rules/other/2022/ia-6050.pdf.

[2] The SEC has imposed accelerated comment deadlines on several recent rulemaking proposals under Chair Gensler. *See*, *e.g.*, The Enhancement and Standardization of Climate-Related Disclosures for Investors, SEC Release Nos. 33-11042 34-94478 (Mar. 21, 2022), *available at* https://www.sec.gov/rules/proposed/2022/33-11042.pdf; and Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews, SEC Release No. IA-5955 (Feb. 9, 2022), *available at* https://www.sec.gov/rules/proposed/2022/ia-5955.pdf. Consistent with the Request for Comment, the original deadline for comments on these proposals was 30 days after publication of the proposal in the Federal Register, or 60 days after publication on the SEC website, whichever was later. The SEC subsequently extended the comment period of the climate-related disclosures proposal and reopened comments on the private fund advisers proposal and another proposal that also had a shorter comment period. SEC Extends Comment Period for Proposed Rules on Climate-Related Disclosures, Reopens Comment Periods for Proposed Rules Regarding Private Fund Advisers and Regulation ATS (May 9, 2022), *available at* https://www.sec.gov/news/press-release/2022-82.

[3] The Request for Comment also suggests a focus on the concentration of the index provider industry. According to the Request for Comment, three index providers account for over two-thirds of the market for indexes, totaling approximately $5.0 billion in revenue in 2021. Request for Comment at 6.

[4] Under the Advisers Act, an "investment adviser" is defined 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 . . . ." 15 U.S.C. 80b-2(a)(11).

[5] The Advisers 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." 15 U.S.C. 80b-2(a)(11)(D). The Request for Comment acknowledges that certain providers rely on the publisher's exclusion while noting that, given the length of time since the courts have construed the applicable standard and understanding that new business models have developed in the interim, the SEC is considering the extent to which providers' activities may raise investment adviser status issues. *See* Request for Comment at 14-15.

[6] Some of the EU Benchmarks Regulation's ("BMR") key provisions include requiring EU administrators of a broad class of benchmarks to be authorized or registered by a national regulator, and for these administrators to implement various governance systems and other controls to ensure the integrity and reliability of their benchmarks. Administrators are also required to provide a code of conduct specifying requirements and responsibilities regarding input data. Although the BMR affects U.S.-based index providers that wish to have market access in the EU, it does not directly affect their business in the U.S. *See* Request for Comment at 26-27.

[7] Request for Comment at 23.

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