Comments on SEC Request for Comment on Information Providers Acting as Investment Advisers

August 16, 2022

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Via Electronic Submission

Ms. Vanessa 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

Dear Ms. Countryman:

The Investment Adviser Association (**IAA**)[1] appreciates the opportunity to comment on the June 15 request for comment on certain information providers acting as investment advisers (**Request**).[2] Investment advisers increasingly use the products and services provided by index providers, model portfolio providers (**model providers**), and pricing services (collectively, **Information Providers**) to help make investment decisions in the best interest of their clients. We appreciate the Commission's efforts in seeking to better understand these Information Providers and associated market practices, their status under the Investment Advisers Act of 1940 (**Advisers Act**), and the implications of their use for investors. We provide our views in this letter regarding certain aspects of the Request.

Information Providers play an important and valuable role in the services advisers provide to their clients. The Commission should thus take care not to raise the costs of doing business for these Information Providers – which would ultimately be passed through to investors – or limit access by erecting barriers to entry for or inadvertently precipitating the market consolidation of Information Providers. The Commission should also confirm that the fiduciary relationship under the Advisers Act – with its attendant obligations – exists between an investment adviser and its clients and not between the adviser's clients and any third-party Information Provider with which such clients have no advisory relationship.

We address both of these points more fully below. We also offer several more general recommendations for the Commission to consider as it assesses the adviser status of Information Providers.[3]

A. The Commission should address the growth of Information Providers without constraining the ability of investment advisers to continue to use their products and services.

Investment advisers' services to clients and their need for products and services from Information Providers are constantly evolving, as are the offerings of Information Providers in response to such demand. Advisers use Information Providers for myriad purposes to help them better serve the best interests of their clients. For example, as described in the Request, an adviser may license information related to indexes from an index provider as a benchmark for performance or for index tracking purposes. It may also act as a model (or program) sponsor and use a model provider to develop a model portfolio based on strategies the adviser wants to offer, either directly to its clients or to other advisers for use with their clients. Similarly, it may use a pricing service to assist the adviser in determining an investment's price or value.

We thus appreciate why the Commission is seeking to better understand the role of Information Providers in the financial services landscape. As the Commission proceeds with its assessment, we request that any action it decides to take be designed to facilitate and not impair the ability of advisers to continue to use the services of Information Providers to serve their clients more effectively.

For instance, we would expect that the regulatory burden on index providers and pricing services of registration under the Advisers Act, if it were required,[4] and the attendant initial and ongoing implementation costs, would be considerable. Such costs would ultimately be borne by investment advisers and their clients as these Information Providers would likely pass them on through increased fees. As it is, the costs of using benchmark/index providers, for example, is quite high and has increased over the years.[5] We strongly believe that pricing services and investment strategies utilizing indexes should remain affordable for investors. We also believe that it is likely that the landscape of index providers and pricing services would shift in response to the additional costs and burdens associated with registration, leading some to exit the market, creating barriers to entry for others, and reducing choices for advisers and hampering their access to these valuable products.

The services of model providers should also not be made more complicated or costly. Model providers, as described in the Request, design allocation models that may be updated or rebalanced over time and provide various degrees of specificity and customization.[6] A wide range of models exists with varied audiences and objectives, and, accordingly, whether a model constitutes advice within the meaning of the Advisers Act should be a facts-and-circumstances analysis.[7] We believe this analysis is effectively undertaken pursuant to the existing regulatory framework, and, in circumstances in which model providers offer investment advice under the

Advisers Act, they would currently need to register as investment advisers absent an exclusion, exemption, or prohibition. As discussed below in response to specific questions in the Request, if the Commission changes its regulatory approach to registered model providers in a way that affects their ability to continue to provide nondiscretionary advice[8] to other investment advisers, we believe that the model providers' costs would also increase and negatively impact their ability to continue to offer these important services.

B. The Commission should confirm that an Information Provider's client is the investment adviser to which the service is provided and not that adviser's end clients.

Investment advisers are responsible for selecting appropriate service providers – including Information Providers – to assist in their provision of fiduciary advice to their clients. Information Providers that provide services to an investment adviser do so pursuant to a contract with the adviser to provide the adviser with a service that will enhance its ability to advise its clients.[9] These Information Providers view the adviser as their client and any duties they owe in connection with the service being provided are owed to the adviser.

Question 29 of the Request asks: "Under what circumstances should a provider that acts as an investment adviser be required to treat as its advisory client another investment adviser that uses its services (the 'serviced adviser')?" Many IAA members are model providers that provide model portfolios to serviced advisers. We understand that registered investment-adviser model providers take the view that, to the extent that their models are providing advice – as opposed, for example, to educational tools – their client is the serviced adviser. The model provider in these circumstances has a fiduciary duty to its serviced adviser client in connection with the services contracted for in the agreement between them.

Question 29 also asks: "Under what circumstances, if any, should such a provider's advisory client be the client, or end-user, of the serviced adviser?" In our view, the end client of a serviced adviser should not be viewed as an Information Provider's advisory client unless the Information Provider has a direct advisory relationship with that client and can, in fact, act as a fiduciary. Information Providers typically have no relationship with a serviced adviser's end clients, undertake no direct obligations to these clients, make no determination as to the appropriateness of any investment for these clients, and in fact have no knowledge of the clients' identities or individual circumstances.[10] In *all* cases, the serviced adviser is the fiduciary to its clients, responsible for making investment decisions in the best interests of these clients, among other obligations.

The Request suggests that "clients [of the serviced adviser] may be unsure which services are being performed by [an Information Provider] and which are being performed by the adviser, as well as by whom they are owed a fiduciary duty."[11] We note that it is the serviced adviser's obligation to make full and fair disclosure to its clients of all facts material to the advisory relationship, including as to the applicable standard of conduct, material services provided in connection with the advice, and the existence of conflicts, among other things. In addition, as the Commission has emphasized, the adviser may not assign or waive its fiduciary obligations to its clients.[12]

Question 8 of the Request asks:

> To what extent do information 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 do providers view the scope of such obligations? Do they view their obligations more narrowly than those of a traditional client-facing adviser, and if so, how? How do these providers address potential conflicts of interest that may arise during their relationships with clients or users of their services?

As noted above, we understand that Information Providers, whether or not they are registered as investment advisers, do not view themselves as having fiduciary obligations to any investors with which they do not have an advisory relationship. Without that relationship, they are not in any position to act as a fiduciary to the investor. We do not believe that it makes sense for the Commission to impose a fiduciary duty on a relationship where there is no privity. The current regulatory framework creates a robust and highly effective fiduciary relationship between serviced advisers and their clients. Commission precedent and the Advisers Act have consistently interpreted fiduciary duties as existing between adviser and client, not client and third-party service provider.

In fact, we believe that it would be confusing and not helpful to clients that have an established fiduciary relationship with a serviced adviser to try to understand what it means for them to have an additional fiduciary relationship with a party that knows nothing about them and has no basis for being able to act in their best interests. Indeed, we are concerned that viewing the Information Provider as a fiduciary to the end client would disrupt the serviced adviser's fiduciary relationship with its clients to the clients' potential detriment in that it may become confusing as between the Information Provider and the serviced adviser as to who owes what obligations to which client.

In the context of model portfolios, specifically, we are concerned that, if the Commission were to view the serviced adviser's end client as the client of the investment-adviser model provider, thereby imposing on the model provider client-facing fiduciary obligations, fees and expenses would undoubtedly increase with no clear benefits. As noted above, currently, model portfolios are generally provided on a nondiscretionary basis, which allows model providers to charge a significantly lower fee than a full discretionary management fee. Mandating an advisory relationship between a model provider and a serviced adviser's clients would increase the model provider's obligations and risks (*e.g.*, to make suitability determinations based on individual circumstances), which would considerably increase costs, causing model portfolio services to be unscalable. Ultimately, investors would be left with fewer choices and higher fees.

Finally, we address the potential consequences of treating registered investment companies (**funds**) advised by registered investment advisers as clients of Information Providers that provide services to the funds' advisers. We believe that the regulatory costs and compliance burdens for all types of Information Providers that could be deemed to be acting as investment advisers to funds would be particularly profound in light of the Investment Company Act's contract renewal obligations, Board oversight requirements, proxy voting implications, and compliance resource costs, among other considerations. These regulatory obligations would create enormous complexity and would also be duplicative, while adding little value, as the investment adviser making investment decisions on behalf of the fund would already be in place and retain full discretion regarding the fund's investments.

For these reasons, we request that, if the Commission moves forward with its consideration of the investment adviser status of Information Providers, it explicitly confirm that the end clients of any investment adviser that obtains services from an Information Provider will not be treated as clients of the Information Providers in the absence of an advisory relationship between these clients and the Information Providers.

C. General Recommendations

In addition to our specific recommendations above, we ask the Commission to consider the general recommendations below as it assesses whether regulatory change with respect to Information Providers is necessary or appropriate:

1. **Leverage existing requirements under the Advisers Act to ensure appropriate disclosure to investors.** We agree with the Commission that it is critical for advisory clients to have a clear understanding of which entity owes them a fiduciary duty, and to receive clear information from their investment advisers regarding contracted services, fees, conflicts of interest, and other material information that affects the advisory relationship. This obligation is and should remain the responsibility of the adviser that has the client relationship, regardless of whether the adviser outsources any functions. We believe that the Advisers Act framework is already designed to ensure that advisers are making appropriate disclosures to their clients and prospective clients about services provided by, fees involved with, and conflicts relating to Information Providers.
2. **Conduct a thorough cost-benefit analysis and consider alternatives.** In considering regulatory objectives, the Commission should articulate clearly the harm that needs to be addressed, balance any assessment of risks and unintended consequences against potential benefits, and consider less burdensome alternatives.
3. **Assess whether the Advisers Act regulatory framework fits the business models of Information Providers and would achieve the Commission's objectives.** The IAA has long taken the position that the principles-based Advisers Act is sufficiently flexible to accommodate a wide range and evolution of adviser business models.[13] We have also recommended and generally supported efforts by the Commission to re-evaluate existing regulations on a regular basis to ensure they remain effective, efficient, tailored, and appropriately targeted to protecting investors and the integrity of our markets and fostering capital formation in a rapidly-evolving landscape.[14] However, the Advisers Act framework may not necessarily be apt for all types of Information Providers in all circumstances, even if they were determined by the Commission to be providing advice for purposes of the Advisers Act.
4. **Clarify treatment of regulatory assets under management.** The Commission requests comment on whether to define RAUM to apply explicitly to model providers. It is difficult to apply the concept of RAUM to model portfolios, given that the model provider is typically unaware of the assets being managed using the model portfolio. Instead of applying RAUM to model providers, the Commission should, we believe, provide clarifying instructions to Form ADV for Item 5.C.(1) – number of clients without RAUM. The IAA has been analyzing Form ADV data for at least 20 years and publishing an Investment Adviser Industry Snapshot (formerly known as Evolution/Revolution).[15] In our experience, it is apparent that many model providers are unclear about the definition/type of client to include in this context. Clarifying the instructions would increase consistency of the reported data.

* * *

We appreciate your consideration of the IAA's comments and would be happy to provide any additional information that may be helpful. Please contact the undersigned at (202) 293-4222 if we can be of further assistance.

Respectfully,

Gail C. Bernstein
General Counsel

Dianne M. Descoteaux
Associate General Counsel

cc:
The Honorable Gary Gensler, Chair
The Honorable Hester M. Peirce, Commissioner
The Honorable Mark T. Uyeda, Commissioner
The Honorable Jaime Lizárraga, Commissioner
The Honorable Caroline A. Crenshaw, Commissioner
William A. Birdthistle, Director, Division of Investment Management

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[1] The IAA is the leading organization dedicated to advancing the interests of investment advisers. For more than 85 years, the IAA has been advocating for advisers before Congress and U.S. and global regulators, promoting best practices and providing education and resources to empower advisers to effectively serve their clients, the capital markets, and the U.S. economy. The IAA's member firms manage more than $35 trillion in assets for a wide variety of individual and institutional clients, including pension plans, trusts, mutual funds, private funds, endowments, foundations, and corporations. For more information, please visit www.investmentadviser.org.

[2] *Request for Comment on Certain Information Providers Acting as Investment Advisers* (**Request**), 87 Fed. Reg. 37254 (June 15, 2022), available at https://www.govinfo.gov/content/pkg/FR-2022-06-22/pdf/2022-13307.pdf.

[3] We look forward to continuing our engagement with the Commission and its staff as it considers the many important questions and issues raised in the Request.

[4]We do not take a position on whether any index providers or pricing services should be deemed to be providing advice within the meaning of the Advisers Act or whether, if they are providing advice, they would qualify for an exclusion or exemption under the Advisers Act.

[5] *See, e.g.,* IAA Testimony, SEC's Asset Management Advisory Committee Meeting, Transcript at 72, September 27, 2021, available at https://www.sec.gov/files/amac-092721-transcript.pdf.

[6] Request, *supra* note 2, at 37255. The Request asks about the adviser status of "third-party" model providers, *i.e.*, model providers that offer model portfolios to investment advisers, which in turn use these models in the delivery of investment advice to their direct advisory clients.

[7] The Request acknowledges that models "can be educational tools that investors use to obtain a sense of which asset classes (as opposed to which specific securities) are appropriate for the investor to allocate its assets to (*e.g.*, 60% in equities, 40% in fixed income)." Request, *supra* note 2, at 37255. Model providers may themselves use these models for educational purposes and may also provide or license these models to investment advisers to be used as tools/educational materials.

[8] While the Request states that model portfolios may be offered "on a discretionary or non-discretionary basis," Request, *supra* note 2, at 37255, we understand that model providers rarely provide discretionary services within the meaning of the instructions to Form ADV, which use "discretionary authority or discretionary basis" to mean: "Your firm has discretionary authority or manages assets on a discretionary basis if it has the authority to decide which securities to purchase and sell for the client. Your firm also has discretionary authority if it has the authority to decide which investment advisers to retain on behalf of the client. *See* Form ADV Part 1A, Instructions, Item 8; Part 1B, Instructions; Part 2A, Items 4, 16, 18; and Part 2B, Instructions. Instead, models are intellectual property of the model provider and the serviced adviser can elect to modify the information in the model in its provision of services to its underlying clients without input from the model provider.

[9] Our comments focus on the provision of model portfolios to investment advisers registered with the SEC or the states, since, to the extent that model portfolios are provided to other financial intermediaries such as banks, trusts, insurance companies, broker-dealers, etc., such entities are subject to separate regulatory regimes that we do not address here.

[10] We note that, in part because of the cybersecurity and other risks related to sharing highly-sensitive personal information, advisers are – in our view appropriately – resistant to sharing their clients' personally identifiable information (**PII**) except as necessary, and they typically would not share any PII. Accordingly, Information Providers are not equipped to make a suitability determination for or to evaluate what is in the best interests of the adviser's clients.

We also note that, while it may be theoretically possible that an Information Provider has a separate, unrelated relationship with a serviced adviser's end client, we believe that any such relationship would have nothing to do with the provision of the Information Provider's services to the serviced adviser.

[11] Request, *supra* note 2, at 37256.

[12] *See Commission Interpretation Regarding Standard of Conduct for Investment Advisers* (**Fiduciary Interpretation**), 84 Fed. Reg. 33669, 33672 (July 12, 2019), available at https://www.govinfo.gov/content/pkg/FR-2019-07-12/pdf/2019-12208.pdf.

[13] *See* Letter from IAA President & CEO Karen L. Barr to SEC Chair Gary Gensler on the Regulation of Investment Advisers (May 17, 2021), available at https://investmentadviser.org/resources/regulation-of-investment-advisers/.

[14] *Id.*

[15] The latest Investment Adviser Industry Snapshot is available at https://investmentadviser.org/wp-content/uploads/2022/06/Snapshot2022.pdf.

TAGS: **SEC Investment Management**

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