

23 December 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](mailto:rule-comments@sec.gov)

**Re: U.S. Securities and Exchange Commission Proposed Rule on Outsourcing by Investment Advisers; File No. S7-25-22 ("Proposed Rule")**

Dear Ms. Countryman,

MSCI Inc. ("MSCI")<sup>1</sup> respectfully submits this letter in response to the Proposed Rule by the U.S. Securities and Exchange Commission (the "Commission").

MSCI recognizes that registered investment advisers are under a fiduciary duty to act in the best interest of their clients. We support efforts that would encourage advisers to ensure that the indexes they use are administered by index providers that adhere to the widely-adopted IOSCO Principles for Financial Benchmarks,<sup>2</sup> which promote index governance, quality and transparency.<sup>3</sup>

The Proposed Rule, however, would impose further prescriptive due diligence requirements on investment advisers before retaining a service provider, as well as an ongoing monitoring requirement after the service provider is retained. Index providers, among others, are identified in the proposing release as potentially providing covered services.<sup>4</sup> While MSCI

---

<sup>1</sup> MSCI has been at the forefront of index construction, calculation and maintenance for more than 50 years. We service institutional clients, including asset managers, asset owners, banks, corporates, insurance companies and wealth managers. We administer our indexes in an objective manner by applying a rules-based approach 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 Benchmarks published by the International Organization of Securities Commissions ("the IOSCO Principles"). 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.

<sup>2</sup> 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>.

<sup>3</sup> Earlier this year, MSCI responded to the Commission's request for public comment related to whether certain information providers, including index providers, should be deemed "investment advisers" under the Advisers Act. (the "RFC"); see MSCI Comment Letter in response to Request for Comment on Certain Information Providers Acting as Investment Advisers, Investment Advisers Release No. 6050 (August 15, 2022), *available at* <https://www.sec.gov/comments/s7-18-22/s71822-20136043-306781.pdf>.

<sup>4</sup> See e.g., Proposed Rule at 68817 ("[I]nvestment advisers have engaged service providers to perform activities that form a central part of their advisory services. Advisers increasingly have engaged index providers to develop bespoke indexes that an adviser may replicate or track in portfolios for its clients...").

agrees investment advisers should exercise appropriate oversight of their service providers to help protect clients and investors from harm, we are concerned that the Proposed Rule relies on misperceptions about the role of indexes and index providers. We set out our primary observations below.

### **Index providers should not be a presumed “covered function”**

The proposal indicates that the determination of a “covered function” to which it would apply depends on the specific facts and circumstance of the function being “outsourced,”<sup>5</sup> yet it also suggests there is a strong presumption that index providers satisfy the criteria despite their limited role as third-party data providers.<sup>6</sup>

The Proposed Rule sets out a two-pronged definition of “covered function”:

- (i) a function or service that is necessary for the adviser to provide its investment advisory services in compliance with the Federal securities laws, and
- (ii) that, if not performed or performed negligently, would be reasonably likely to cause a material negative impact on the adviser’s clients or on the adviser’s ability to provide investment advisory services.<sup>7</sup>

Index providers are not “necessary for the adviser to provide its investment advisory services in compliance with the Federal securities laws.” Index providers are third-party data providers that use transparent, rules-based methodologies. As such, they do not provide an outsourced function that an adviser typically would be expected to perform itself or data that an adviser typically would be expected to calculate for itself. Nor does designing, calculating or licensing an index constitute or involve the provision of investment advice so it is not an outsourced or delegated advisory activity.<sup>8</sup> Index providers have a limited role in the capital markets ecosystem that is clearly defined: to draft index methodologies, calculate the associated indexes based on the methodologies, and publish and license that information to market participants to use as they see fit, such as for performance benchmarking, research, reporting, and indexed product creation.<sup>9</sup>

Investment advisers request indexes from index providers and determine which indexes to use and for what purposes. Index providers do not recommend indexes to their clients to achieve a particular investment outcome. An index is simply a weighted average of a group of securities, commodities or other assets (“Index Constituents”), not a recommendation to buy, sell or hold Index Constituents, an assessment of the value or potential return of those

---

<sup>5</sup> “The determination of what is a covered function also would depend on the facts and circumstances, as the proposed rule is meant to encompass functions or services that are necessary for a particular adviser to provide its investment advisory services.” Proposed Rule at 68821.

<sup>6</sup> For a discussion of the definitional terms “Covered Function” and “Service Provider” and their proposed application to index providers, see Proposed Rule at 68821-23.

<sup>7</sup> Proposed Rule at 68820.

<sup>8</sup> 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”) without making any recommendations or advising whether to buy, sell or hold any or all Index Constituents. This is true regardless of the type of index – whether broad or narrow, standard or custom, licensed by one client or licensed by many clients.

<sup>9</sup> See the website of the Index Industry Association; available at <https://www.indexindustry.org/advocacy/>

Index Constituents or an analysis or a report concerning Index Constituents. This does not change in the context of what the proposal refers to as “custom” or “bespoke” indexes. For “custom” indexes, MSCI allows clients to customize an index by requesting changes. MSCI then includes the requested client-defined specifications in the rules-based index methodology and applies the same index construction and index governance as in our core index offerings. These custom indexes, just like standard indexes, simply compute the return of an identified group of Index Constituents.

We also note that the proposing release includes a hypothetical potential conflict of interest involving index providers, which we believe is inapposite. The proposing release describes an “index provider that holds an investment it subsequently adds to its widely followed index... because it would directly benefit from creating or increasing demand for that investment.”<sup>10</sup> MSCI indexes are calculated strictly in accordance with our rules-based methodologies which are publicly available on [www.msci.com](http://www.msci.com). Stocks are added or removed from our indexes based solely on whether they meet the thresholds as outlined in the methodologies. We rebalance our indexes quarterly or semi-annually as detailed in our methodologies and we publicly announce the results of those rebalancings on dates that are publicly announced in advance. Whether or not a company is included in the MSCI indexes is strictly determined by whether it meets the thresholds in the methodologies. Further, MSCI does not create or trade financial products based on MSCI indexes and it does not invest in or hold the securities of the companies contained in its indexes, and as such, MSCI does not have an interest in the outcome of the performance levels of any particular index or company.

Even assuming the hypothetical is plausible it would likely be a violation of law independent of whether the index provider is subject to enhanced due diligence requirements.<sup>11</sup>

### **The investment adviser fiduciary duty extends to the use of index providers**

If an investment adviser chooses to license an index and have its client funds or accounts seek performance results that track such index, the investment adviser and the board of any registered investment company are under an obligation to provide oversight of that service. As noted in the proposing release, an investment adviser has a fiduciary duty to its clients under federal securities law that comprises a duty of loyalty and a duty of care that extends to the use of service providers.<sup>12</sup> The use of a particular service, including the provision of indexes, does not change an adviser’s obligations under federal securities law.<sup>13</sup>

If the Commission determines there should be an additional layer of oversight of index providers used by investment advisers, it is not necessary to establish a unique category of “covered functions” that are “necessary for the adviser to provide its investment advisory services in compliance with Federal securities laws.” Instead, the Commission could issue robust guidance reminding investment advisers that their existing fiduciary duty to their

---

<sup>10</sup> SEC Proposed Rule, File No. S7-25-22, Federal Register, pg. 68818.

<sup>11</sup> The Commission has previously rejected the need to impose any additional regulatory requirements or conditions, such as to address conflicts of interest, to an index provider affiliated with an adviser where there are adequate existing requirements under federal securities laws. See 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.

<sup>12</sup> See Proposed Rule at 68819.

<sup>13</sup> *Id.*

clients includes the obligations to conduct due diligence of service providers and to monitor them.

**The Proposed Rule will increase costs and will require additional time for implementation**

The Proposed Rule could add cost and complexity to the onboarding by advisers of service arrangements and will require an extended implementation timeframe for advisers and the industry to determine and implement these requirements. The proposing release states that the compliance date would be ten months from the effective date of the final rule. If the Commission moves forward with a final rule, we recommend a much longer implementation timeframe to avoid compounding any unnecessary costs and burdens that ultimately would be passed to investors.

\* \* \*

MSCI would like to thank the Commission for its consideration of its 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**