Via Electronic Mail

December 23, 2022

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

Re: File No. S7-25-22 – Outsourcing by Investment Advisers

Dear Secretary Countryman:

The Securities Industry and Financial Markets Association ("SIFMA")[1] and SIFMA Asset Management Group ("SIFMA AMG")[2] appreciate the opportunity to comment on the proposed new rules and amendments governing outsourcing by investment advisers issued by the Securities and Exchange Commission ("Commission" or "SEC"). These proposals, if adopted, would establish a new due diligence and oversight regime for investment advisers' use of service providers.[3] We appreciate the opportunity to address various issues despite the short comment period for this extensive set of proposed rules and amendments.

* * *

[1] SIFMA is the leading trade association for broker-dealers, investment banks, and asset managers operating in the U.S. and global capital markets. On behalf of our members, we advocate for legislation, regulation, and business policy affecting retail and institutional investors, equity and fixed income markets, and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA).

[2] SIFMA AMG brings the asset management community together to provide views on U.S. and global policy and to create industry best practices. SIFMA AMG's members represent U.S. and global asset management firms whose combined assets under management exceed $45 trillion. The clients of SIFMA AMG member firms include, among others, tens of millions of individual investors, registered investment companies, endowments, public and private pension funds, UCITS and private funds such as hedge funds and private equity funds. For more information, visit http://www.sifma.org/amg. SIFMA and SIFMA AMG appreciate the assistance of Willkie Farr & Gallagher in the preparation of this response.

[3] Outsourcing by Investment Advisers, Release No. IA-5956 (Oct. 26, 2022), 87 FR 68816 (Nov. 16, 2022), https://www.federalregister.gov/documents/2022/11/16/2022-23694/outsourcing-by-investment-advisers.

I. Executive Summary

While SIFMA and SIFMA AMG share the Commission's interest in protecting clients through appropriate oversight of service providers by investment advisers when a necessary function or service is outsourced, below are our primary concerns with the proposal:

- Existing fiduciary principles are sufficient to regulate advisers' use of service providers, and tailored guidance on specific topics may better achieve the Commission's objectives.

- The scope of "covered function" should be narrowed to functions that: (i) are "critical" to the adviser's ability to provide advisory services; and (ii) would otherwise be undertaken by the adviser itself. We also propose excluding certain categories of service providers, such as affiliates and service providers that are subject to comprehensive independent federal regulatory regimes, from the scope of the proposed rule.

- A risk-based framework for service provider selection and oversight by advisers would accord better with industry practice and provide more flexibility to assess, manage and prioritize risk. A risk-based framework would allow advisers to adapt their programs effectively to changing service provider needs and is best practice in the industry today.

- Advisers should be permitted to rely on contractual obligation of a service provider for purposes of determining that any subcontractors have the competence, capacity and resources to perform the covered functions in a timely and effective manner for any subcontractor arrangements that would be material to the service provider's performance of the covered functions.

II. Fiduciary Duties Are Sufficient to Govern Advisers' Use of Service Providers

As a threshold matter, we do not believe that the proposed rule is necessary to achieve the Commission's objectives. An investment adviser is a fiduciary subject to a principles-based standard adaptable to unique and evolving circumstances, including with respect to how advisers utilize service providers to provide investment advisory services to clients. As the Commission states in the proposing release, "[o]utsourcing a particular function or service does not change an adviser's obligations under the Advisers Act and the other federal securities laws."[4] The proposing release cites to a handful of SEC enforcement actions brought under Section 206 that involve a service provider in some fashion, showing that the Commission has effectively used existing authority to promote advisers' service provider oversight.[5] At the same time, the paucity of these actions suggests that service provider oversight is not a problem that can only be solved by rulemaking. Instead, the lack of enforcement actions in this area suggests that advisers are thoughtfully discharging their existing fiduciary duties with respect to service providers. It is not apparent to us, therefore, why an investment adviser's existing fiduciary obligations are insufficient to regulate advisers' use of service providers. In light of the concerns we discuss below, we think the Commission's historical approach of examination oversight and the issuance

[4] *Id.* at 68819.

[5] *Id.* at 68818-19.

of tailored guidance regarding existing obligations is a better alternative for achieving the Commission's objectives.[6]

III. The Definition of "Covered Function" Is Unnecessarily Broad

The proposal would define a "covered function" as a function or service that is necessary to provide advisory services in compliance with the federal securities laws, and 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.[7] In our view, the scope of functions included in the definition of "covered function" is the most consequential aspect of the proposal. While expressly excluding "clerical, ministerial, utility, or general office functions or services," the proposed definition of "covered function" nonetheless does not set clear, practical parameters for the scope of the proposed rule's requirements.

The definition of "covered function" proposed is broad enough to sweep in practically any function or service that an adviser retains a service provider to perform. There are a sizable number of functions or services that might be deemed "necessary" for an adviser to provide its investment advisory services in compliance with the federal securities laws.[8] Given that the Commission's economic analysis estimates advisers will have an average of five or six covered functions, however, this overly broad scope must not be the intended consequence of this proposal.[9] A lack of clarity from the Commission will compel advisers to choose between over-inclusion and the attendant costs of needless compliance, on the one hand, and under-inclusion and the attendant risks of a process-based deficiency or enforcement action, on the other hand.

Many of these functions, while no doubt important, would fall outside of the scope of analogous regulatory regimes for outsourcing, which focus on "critical" functions or systems as a core

---

[6] *See, e.g.*, SEC Division of Examinations, Risk Alert: Safeguarding Customer Records and Information in Network Storage – Use of Third Party Security Features (May, 23, 2019) (highlighting inadequate oversight of vendor-provided network storage solutions), https://www.sec.gov/files/OCIE%20Risk%20Alert%20-%20Network%20Storage.pdf.

[7] Proposed rule 206(4)-11(b).

[8] *See* Commissioner Mark T. Uyeda, Statement on Proposed Rule Regarding Outsourcing by Investment Advisers (Oct. 26, 2022) ("Many functions or services that do not relate to an adviser's investment advisory function nonetheless are necessary for the adviser to provide its investment advisory services in compliance with the federal securities laws. Therefore, under a technical reading of the proposed definition of 'Covered Function,' almost any function outsourced by an investment adviser could trigger the numerous oversight functions set forth in the proposed rule."), https://www.sec.gov/news/statement/uyeda-statement-service-providers-oversight-102622. The proposal itself lists fourteen categories of covered functions for Form ADV reporting.

[9] Release No. IA-5956, *supra* note 3, 87 FR at 68855 and 68867. We further note that the Commission's estimate of costs expects that an adviser will dedicate just six hours to developing the scope of "covered function" and making the required list of outsourced covered functions. *Id.* at 68867.

concept.[10] Comparable regulatory regimes also limit covered functions to those handled by a third party that the registrant otherwise would be expected to perform itself.[11]

Consistent with the approaches taken by other regulators, we propose defining a "covered function" more precisely than proposed. Specifically, we suggest defining a covered function as one that: (i) is "critical" to the adviser's ability to provide advisory services; and (ii) would otherwise be undertaken by the adviser itself. We would interpret "critical" in this context to refer to those functions that are essential to the day-to-day provision of advisory services. This would include core functions relating directly to management of client assets, as well as operations fundamental to the investment process and provision of advisory services to the client, such as recordkeeping services, but would exclude functions, such as cybersecurity, index licensing, and legal and consulting roles, that are ancillary to the actual provision of advisory services. The second prong of our proposed definition would exclude functions, like custody, that clients would not ordinarily expect an adviser to do itself. Determinations of the functions that constitute a covered function should be made by the adviser, the party best positioned to determine what is critical.

In addition to the incorporation of the concept of "critical" functions, certain categories of service providers that provide services that are separately regulated should be explicitly excluded from the proposed rule's scope:

- Service providers for registered investment companies, such as transfer agents, fund administrators, principal underwriters and custodians, are subject to oversight at the fund level under Rule 38a-1 under the Investment Company Act of 1940 and should be outside of the scope of the proposed rule.

- Service providers that are subject to comprehensive independent federal regulatory regimes, such as broker-dealers and banks, should be excluded from the rule's scope to avoid potentially duplicative or inconsistent requirements.

- Service providers performing functions regulated by other SEC rules, such as proxy voting advisory firms, custodians (as under Rule 206(4)-2, the "custody rule" under the

[10] *See, e.g.*, Article 30 of Commission Delegated Regulation (EU) 2017/565 (Apr. 25, 2016) (defining when an operational function is "critical or important"), https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017R0565&from=EN. *See also* Proposed Interagency Guidance on Third-Party Relationships: Risk Management, 86 FR 38182, 38187 (Nov. 16, 2022) (defining "critical activities"), https://www.govinfo.gov/content/pkg/FR-2021-07-19/pdf/2021-15308.pdf. We note that an adviser's fiduciary obligations would continue to apply with respect to service providers for non-covered functions.

[11] *See, e.g.*, International Organization of Securities Commissions, Principles on Outsourcing (Oct. 2021), at 8 (defining "outsourcing" by reference to functions performed by a service provider that "would otherwise be undertaken by the regulated entity itself"), https://www.iosco.org/library/pubdocs/pdf/IOSCOPD687.pdf. *See also* Basel Committee on Banking Supervision, Outsourcing in Financial Services (Feb. 2005), at 4 ("perform activities on a continuing basis that would normally be undertaken by the regulated entity"), https://www.bis.org/publ/joint12.htm. *See also* National Futures Association ("NFA") Interpretive Notice 9079 – NFA Compliance Rules 2-9 and 2-36: Members; Use Of Third-Party Service Providers (Sept. 30, 2021) (describing NFA members' responsibilities with respect to third-party service providers that "perform certain functions that would otherwise be undertaken by the Member itself to comply with NFA and CFTC Requirements"), https://www.nfa.futures.org/rulebooksql/rules.aspx?Section=9&RuleID=9079.

Investment Advisers Act of 1940 (the "Advisers Act")), soft dollar research providers and cybersecurity and information technology providers, should be excluded from the rule's scope to avoid having overlapping but potentially different regulatory requirements for the same function.

IV. A Risk-Based Framework for Due Diligence Should Be Used Instead of a One-Size-Fits-All Approach

Notwithstanding that we do not believe the proposal is necessary to regulate investment advisers' use of third-party service providers, we recognize that the general principles embodied in the proposal are consistent with industry practice and other regulatory frameworks governing the use of service providers. Certain aspects of the proposal, however, would upend existing systems for vendor due diligence of thousands of diverse advisers that have implemented tailored approaches to respond to the particularized risks of their businesses in favor of a prescriptive, one-size-fits-all approach. Specifically, the proposed rule would require an adviser to reasonably identify and determine that it would be appropriate to outsource the covered function, that it would be appropriate to select the service provider, and once selected, that it is appropriate to continue to outsource the covered function, by complying with six specific elements enumerated in the proposed rule.[12] The Commission can achieve its objectives without a prescriptive mandate. As an alternative, we suggest that the Commission consider expressly incorporating a risk-based framework for vendor due diligence into the rule. In our experience, this kind of flexible, risk-based approach allows advisers to adapt their programs effectively to changing service provider needs and is best practice in the industry today.

On its face, the proposal's one-size-fits-all approach subjects all advisers and service providers to the same requirements regardless of size, function, importance, capabilities and other differences. As the Commission noted in the proposing release, this approach extends even to affiliated service providers.[13] We see no benefit to clients or the Commission from imposing formal due diligence requirements on affiliate relationships when advisers operate under a shared services model as part of a larger organization. In such cases, affiliates may be subject to the same risk and compliance controls as the adviser, or an affiliate itself may conduct due diligence on vendors serving an organization, including the adviser. We therefore request that the Commission exclude affiliated service providers in these circumstances from the definition of "service provider" under the rule.[14] We also believe that an exception should be provided for advisers that are dually registered as broker-dealers, as these firms already have a supervisory obligation that extends to their outsourcing of certain covered activities.[15]

---

[12] Proposed rule 206(4)-11(a)(1).

[13] Release No. IA-5956, *supra* note 3, 87 FR at 68823.

[14] Alternatively, the Commission should affirm that advisers may take the specific facts and circumstances relating to an affiliated entity into account in administering their risk-based due diligence and oversight programs for service providers.

[15] *See* Financial Industry Regulatory Authority ("FINRA") Rule 3110; FINRA Regulatory Notice 21-29 – FINRA Reminds Firms of their Supervisory Obligations Related to Outsourcing to Third-Party Vendors; FINRA Notice to Members 05-48 – Members' Responsibilities when Outsourcing Activities to Third-Party Service Providers.

The nature of the burden on advisers because of the proposal will depend on their size. Large advisers will bear a significant burden due to their many service provider relationships and will have to reallocate resources away from other priorities to marshal the additional compliance resources required. Smaller advisers with fewer service provider relationships, but also fewer resources, may still be spread thin and need to become even more reliant on service providers to handle growing regulatory burdens. It is possible, conversely, that smaller advisers may find themselves unable to retain certain service providers that elect to scale back their business with investment advisers in response to heightened due diligence burdens.[16]

Under a risk-based approach, advisers would have flexibility as to how best to prioritize, assess and manage the risks related to their businesses and the service providers they engage based on their individual circumstances. This would include circumstances where it may not be practicable for advisers to conduct extensive or tailored due diligence for certain types of service providers that are unlikely to be sensitive to an adviser's particular regulatory needs because they are not geared toward serving the investment advisory industry (*e.g.*, cloud providers). This is particularly the case for advisers, such as smaller advisers without substantial negotiating power and those that use standardized, off-the-shelf solutions, who may not be able to obtain in all cases the specific assurances in their contracts required under the proposal.

V. Risks in Subcontracting Relationships Should Be Governed by Contract

The proposed rule would require that the adviser determine whether the service provider has any subcontracting arrangements that would be material to the service provider's performance of the covered function.[17] In the event of such a subcontracting arrangement, the proposed rule would also require the adviser to identify and determine how it will mitigate and manage potential risks to clients or its ability to perform advisory services in light of any such subcontracting arrangement. It will be difficult in many instances for advisers to achieve visibility into the subcontracting relationships of third-party service providers. Service providers may be reluctant to expose their operational structures for commercial, security or regulatory reasons. Advisers consequently may be unable to make threshold materiality determinations concerning a service provider's subcontracting practices. Advisers generally will not be in a position to monitor subcontractor changes and in any event will not have greater expertise in vendor selection for a service provider's business than the service provider itself. The provider's expertise—and an

[16] *See* Uyeda Statement, *supra* note 8 ("One possibility is that the burdensome nature of the service provider oversight requirements could cause certain service providers to cease doing business with smaller advisers altogether."). It also is possible that certain service providers will withdraw entirely from servicing investment advisers. *See also* Compliance Programs of Investment Companies and Investment Advisers, Release No. IA-2204, 68 FR 74713, 74715 (Dec. 24, 2003) (adopting Rule 206(4)-7) ("The Commission is sensitive to the burdens the rule may impose upon smaller advisory firms. The rule requires only that the policies and procedures be *reasonably* designed to prevent violation of the Advisers Act, and thus need only encompass compliance considerations relevant to the operations of the adviser. We would expect smaller advisory firms without conflicting business interests to require much simpler policies and procedures than larger firms that, for example, have multiple potential conflicts as a result of their other lines of business or their affiliations with other financial service firms. The preparation of these simpler policies and procedures and their administration should be much less burdensome." (footnotes omitted)), https://www.federalregister.gov/documents/2003/12/24/03-31544/compliance-programs-of-investment-companies-and-investment-advisers.

[17] Proposed rule 206(4)-11(a)(1)(iv).

adviser's lack of expertise—is often the reason why an adviser elects to outsource the function in the first place.

Advisers today seek to address subcontractor risks through contractual terms that hold a service provider responsible for the actions or omissions of its subcontractors as if they were those of the provider. Service provider contracts also may include requirements relating to subcontractors' information security programs and other security measures, such as background checks. We think such terms have proved to address appropriately the risks to advisers created by service providers' subcontracting arrangements and are likely to be the most effective terms that advisers can expect to negotiate. We request that the Commission affirm that advisers would be permitted to rely on this type of contractual obligation of a service provider for purposes of determining that any subcontractors have the competence, capacity and resources to perform the covered functions in a timely and effective manner for any subcontractor arrangements that would be material to the service provider's performance of the covered functions.

VI. The Commission Should Expressly Incorporate a Reasonableness Standard

The proposed rule includes language that ought to establish a reasonableness standard for advisers' compliance with its requirements. However, based on our experience with other Commission rules with similar reasonableness language such as Rule 206(4)-7 under the Advisers Act, we are concerned that advisers may be held to a de facto strict liability standard when it comes to service providers.[18] If it intends to adopt the proposal in some form, the Commission should incorporate a true standard of reasonableness into the rule and Commission guidance. We request that the Commission clearly affirm that advisers are not subject to a strict liability standard for service provider incidents and may tailor their due diligence and oversight practices to fit the nature, scope, and risk profile of a covered function and potential service provider.

VII. Public Disclosure Presents Risks to Advisers and Clients

The Commission has proposed that advisers publicly disclose their service providers in Form ADV so that the Commission can oversee the practices of individual firms and monitor trends in the industry.[19] The proposed public disclosure raises significant concerns as it would expose advisers, service providers and clients to unnecessary risks without commensurate benefit. Advisers and service providers will need to be concerned about the potential for bad actors to target key service providers, such as cybersecurity vendors, with malicious activity using publicly available

[18] The proposing release notes two recent enforcement actions that involved third parties as a rationale for rulemaking. Release No. IA-5956, *supra* note 3, 87 FR at 68819. In both cases, the Commission seems to imply that better diligence and oversight would have prevented the issues. Whether or not this is true as a matter of fact, it raises the question of whether a service provider issue will inevitably lead to a regulatory violation. Rule 206(4)-7 includes a reasonableness standard, and Commission enforcement actions against advisers typically cite a violation of Rule 206(4)-7 when other failures are present. *See also*, SEC Division of Examinations, Risk Alert: OCIE Observations: Investment Adviser Compliance Programs (Nov. 19, 2020) (noting that "[d]eficiencies related to the Compliance Rule have been amongst the most common cited by" examination staff), https://www.sec.gov/files/Risk%20Alert%20IA%20Compliance%20Programs_0.pdf.

[19] Proposed Form ADV, Part 1A, Item 7.C., and Section 7.C. of Schedule D. *See* Release No. IA-5956, *supra* note 3, 87 FR at 68834-35.

information. This risk will be amplified, and could blossom into a systemic risk, as a result of the expected consolidation of service providers if the proposal is adopted.[20]

The proposed public disclosure of service providers is unnecessary to accomplish the Commission's goals and would be an outlier compared to analogous diligence and oversight frameworks for service providers under other regimes and in other jurisdictions, such as the United Kingdom, Australia, and Singapore.[21] While information about service providers may be desirable for the Commission, we are skeptical that additional information about service providers will be material to a reasonable investor's assessment of an adviser or outweigh the risks created by public disclosure, including compelled disclosure of confidential trade secrets by an adviser about its business.[22] Public disclosure also may not be permitted by the terms of certain service provider agreements.

Fortunately, there are alternatives to public disclosure that would provide the Commission with relevant information about advisers' use of service providers, while limiting these risks. An enhanced recordkeeping requirement would strengthen the Commission's ability to assess practices, collect market information through examinations and police violations through enforcement. Alternatively, advisers could be required to disclose the information to the Commission on a confidential basis, similar to the approach taken with Form PF.[23]

VIII. The Proposal Raises Concerns About Concentration, Competition and Innovation

The proposal raises concerns about the concentration of service providers in the investment adviser industry and the potential negative effects on competition that the proposal may entail. The increased regulatory costs facing service providers may be substantial and could stifle innovation and competition among service providers generally, potentially resulting in fewer service provider options or a less sophisticated, more costly and/or lower quality service for advisers and clients.[24] We are concerned that the proposed rule would place smaller service providers at a competitive

[20] *See* Section VIII *infra*.

[21] *See* U.K. Financial Conduct Authority, Outsourcing and Operational Resilience (last updated July 21, 2022), https://www.fca.org.uk/firms/outsourcing-and-operational-resilience; Australian Securities and Investments Commission, RG 104 – AFS licensing: Meeting the general obligations (June 2022), https://asic.gov.au/regulatory-resources/find-a-document/regulatory-guides/rg-104-afs-licensing-meeting-the-general-obligations/; Monetary Authority of Singapore, Guidelines on Outsourcing (last revised Oct. 5, 2018), https://www.mas.gov.sg/regulation/guidelines/guidelines-on-outsourcing. *See also* NFA Interpretive Notice 9079, *supra* note 11.

[22] We note that investors already receive information about certain service providers, including sub-advisers, in fund prospectuses, offering memoranda and Form ADV brochures.

[23] *See* Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF, Release No. IA-3308, 76 FR 71128, 71155-56 (Nov. 16, 2011) (discussing confidentiality of Form PF data), https://www.federalregister.gov/documents/2011/11/16/2011-28549/reporting-by-investment-advisers-to-private-funds-and-certain-commodity-pool-operators-and-commodity.

[24] We note that the proposing release does not estimate the downstream costs of the proposal for service providers. *See* Bloomberg v. SEC, No. 21-1088 (D.C. Cir. Aug. 16, 2022) (finding that the Commission's approval of a FINRA proposal was arbitrary and capricious because the Commission neglected to give a reasoned explanation in response to Bloomberg's significant concerns about the costs that FINRA, as well as market participants, will incur in connection with the creation and maintenance of a data service), https://www.cadc.uscourts.gov/internet/opinions.nsf/A1390C785B2A244B852588A000517586/$file/21-1088-1959474.pdf.

disadvantage compared to larger service providers that provide a full suite of services. We anticipate, therefore, that the proposal would heighten concentration risk for the investment adviser industry by driving consolidation to those larger service providers.

Incumbent and established service providers also may stand to benefit from a herd mentality and become more entrenched as the barrier to entry facing new service providers increases. This would have the result of stifling innovation by service providers of all sizes. Finally, we note that the competitive challenges faced by new service providers that lack extensive track records could lead to results at odds with the Commission's goal of promoting the consideration of DEI factors in service provider selection.[25]

IX. Advisers Will Need At Least 18 Months to Implement the Rules as Proposed

The Commission has proposed an implementation period of ten months from the rule's effective date.[26] Ten months, in our view, is not close to enough time for advisers to complete the substantial efforts that will be required of advisers if the proposal is adopted. Advisers will need to establish new compliance programs, including policies and procedures, governing due diligence and oversight of service providers or refashion existing programs to comply with the rule's requirements. To accomplish these tasks will require significant time and effort on the part of advisers and the cooperation of a wide range of service providers, all of which we believe warrant a longer implementation period—of at least 18 months—that takes into account potentially overlapping compliance dates for other Commission proposals yet to be finalized.[27]

Though not expressly required by the proposal, advisers in practice may feel compelled to update their diligence files on existing service providers and attempt to renegotiate service agreements with them to comply with the specific text of the rule. For those few advisers able to bring service providers back to the negotiating table, such negotiations are likely to be a long and costly process. Advisers in some cases may need to terminate existing service providers, which can be a lengthy and expensive unwinding process requiring advance notice under contractual obligations, and engage in a long and costly due diligence and onboarding process to replace providers to comply with the rule.[28] In any event, advisers will need to take similar steps to prepare to conduct ongoing due diligence monitoring of their service providers and comply with the proposed recordkeeping obligation for a potentially sizable number of service providers.

The Commission's economic analysis estimates advisers will have an average of five or six covered functions.[29] Anecdotal evidence from our membership suggests, however, that this

---

[25] Service providers with past operational or regulatory incidents may experience similar competitive hurdles as a result of the proposal.

[26] Release No. IA-5956, *supra* note 3, 87 FR at 68841.

[27] We note that in many cases the same staff at an adviser will be responsible for implementing this proposal and a number of others at the same time. We ask the Commission to take this into account when establishing potentially overlapping implementation periods.

[28] Anecdotal evidence from our membership suggests that in some circumstances it can take a year or longer to conduct initial due diligence on a service provider, negotiate, prepare and execute a written agreement with a service provider, and onboard and integrate a service provider into the adviser's business or operations.

[29] *Id.* at 68855 and 68867.

estimate likely significantly understates the actual burden on advisers. Economic analysis, while still inadequate, would better align with the likely economic impact of the proposal on advisers if the proposal included materiality and risk-ranking elements of the sort described in this letter that would limit the number of service providers covered by the rule while still achieving the Commission's objective of enhanced adviser oversight of important service providers.

Should the Commission adopt the proposal in some form, numerous interpretive questions may need to be resolved during the implementation period with help in the form of guidance from the Commission and its staff. Set forth below is a sample of the myriad topics on which investment advisers might seek interpretive guidance during the implementation process:

- Advisers will want guidance about the level of oversight they are expected to provide over service providers—*i.e.*, daily supervision versus periodic monitoring—and how to determine the necessary level of oversight.[30]

- Advisers will want guidance about what constitutes a "material negative impact" for purposes of the definition of covered function and how to assess when a material negative impact would occur.

- Advisers will want guidance that they will not be expected because of the rule to retain secondary or "back up" service providers as a failsafe measure.

- Advisers will want guidance concerning substituted compliance with analogous federal and non-U.S. regimes governing service provider due diligence and oversight.

- Advisers will want guidance about the scope of the materiality standard in respect of subcontracted functions.

In addition, the Commission has issued a number of proposals simultaneously that individually are of great consequence to the investment adviser industry.[31] As we have urged elsewhere, we are concerned that the brevity of the comment periods for individual proposals, combined with their stacking one upon another, places a heavy burden on the industry to evaluate fully each proposal on its own terms and in combination with the others and provide the Commission with thoughtful

[30] We note that the Commission's estimates suggest that advisers will spend less than two hours per week on monitoring for each covered function. *See id.* at 68858 (estimating an upper bound for ongoing annual costs of 88 hours). More robust oversight for particular covered functions or in general would increase costs accordingly.

[31] *See, e.g.*, Cybersecurity Risk Management for Investment Advisers, Registered Investment Companies, and Business Development Companies, Release No. IA-5956, 87 FR 13524 (Mar. 9, 2022), https://www.federalregister.gov/documents/2022/03/09/2022-03145/cybersecurity-risk-management-for-investment-advisers-registered-investment-companies-and-business; Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews, Release No. IA-5955, 87 FR 16886 (Mar. 24, 2022), https://www.federalregister.gov/documents/2022/03/24/2022-03212/private-fund-advisers-documentation-of-registered-investment-adviser-compliance-reviews. The Commission also has issued a request for comment on matters related to the activities of certain "information providers," the eventual consequences of which are unknown. *See* Request for Comment on Certain Information Providers Acting as Investment Advisers, Release No. IA-6050, 87 FR 37254 (June 22, 2022), https://www.federalregister.gov/documents/2022/06/22/2022-13307/request-for-comment-on-certain-information-providers-acting-as-investment-advisers.

feedback.[32] It is particularly difficult under these circumstances to analyze the potential effects on one proposal that will stem from another proposal since both are subject to change. The interaction of the Commission's proposed new rules for advisers to private funds and this proposal provides an example of the challenge. Private fund advisers would effectively be subject to a negligence standard for liability under the proposed private fund rules.[33] If both proposals are adopted as proposed, advisers will have no choice but to insist on a negligence standard with their service providers or, more likely, bear the risk of a different standard themselves. Until one of the proposals is finalized, however, industry commenters can only speculate about the effects of the proposals on one another and on other proposals. In the event one or more of these overlapping proposals is adopted, we urge the Commission to be thoughtful about the sequence of compliance dates.

X. Promulgation Under Antifraud Provision Exceeds Statutory Authority

We are concerned that the Commission, in pursuing the goal of protecting clients through appropriate oversight of service providers by investment advisers, has chosen to rely on its antifraud authority in Section 206 of the Advisers Act, which prohibits an adviser from engaging in "any act, practice, or course of business which is fraudulent, deceptive, or manipulative."[34] We question whether a regulatory framework for service provider due diligence and oversight falls under traditional notions of fraud, deception and manipulation. Consequently, we believe that this antifraud provision is not an appropriate source of statutory authority for imposing a service provider due diligence and oversight regime and could lead to unwarranted Commission enforcement action against advisers acting in good faith.[35]

* * *

[32] *See* Joint comment letter from SIFMA et al. (Nov. 16, 2022), https://www.sec.gov/comments/s7-26-22/s72622-20150876-319897.pdf; Joint comment letter from SIFMA et al. (Apr. 5, 2022) ("The number of rule proposals, the complexity of the issues being tackled, the potential interconnectedness of the proposals, and lurking possible negative, unintended consequences should be considered when setting a proposal's comment period. The Associations are concerned that the Commission's current approach to comment period lengths does not take such an approach and ultimately does not comport with the spirit of the APA and applicable federal guidelines on rulemaking procedure."), https://www.sifma.org/resources/submissions/importance-of-appropriate-length-of-comment-periods.

[33] *See* Release No. IA-5955, *supra* note 31, 87 FR at 16925.

[34] 15 U.S.C. § 80b-6(4).

[35] *Cf.* SIFMA comment letter (Apr. 11, 2022) (arguing that the cybersecurity proposal exceeds the Commission's authority under Section 206 of the Advisers Act), https://www.sec.gov/comments/s7-04-22/s70422-20123336-279624.pdf.

SIFMA and SIFMA AMG appreciate your consideration of this request. If you have questions or would like to discuss these comments further, please reach out to Melissa MacGregor at (202) 962-7385 or Kevin Ehrlich at (202) 962-7336.

Sincerely,

Melissa MacGregor
Managing Director & Associate General Counsel
SIFMA

Kevin Ehrlich
Managing Director
SIFMA Asset Management Group

cc: The Hon. Gary Gensler, Chair, U.S. Securities and Exchange Commission
The Hon. Hester M. Peirce, Commissioner, U.S. Securities and Exchange Commission
The Hon. Caroline A. Crenshaw, Commissioner, U.S. Securities and Exchange Commission
The Hon. Mark T. Uyeda, Commissioner, U.S. Securities and Exchange Commission
The Hon. Jaime Lizárraga, Commissioner, U.S. Securities and Exchange Commission
Mr. William A. Birdthistle, Director, Division of Investment Management, U.S. Securities and Exchange Commission