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

Submitted electronically via rule-comments@sec.gov

December 19, 2022

Dear Ms. Countryman,

Outsourcing by Investment Advisers (File No. S7-25-22)

The Alternative Investment Management Association (AIMA)[1] welcomes the opportunity to comment on the U.S. Securities and Exchange Commission's (SEC or Commission) proposed rule to prohibit registered investment advisers ("advisers") from outsourcing certain services or functions without first meeting minimum requirements (the "Proposal").[2]

We would like to state at the outset that the significant number of rule proposals, which have been issued by the Commission in quick succession, has meant that our member firms have been overwhelmed and therefore unable to give each particular rule proposal their full attention. As a result, we would like to again raise our concerns that, despite our requests[3] to extend the comment periods, the Commission's overlapping and serially short comment periods have not provided

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1 The Alternative Investment Management Association (AIMA) is the global representative of the alternative investment industry, with around 2,100 corporate members in over 60 countries. AIMA's fund manager members collectively manage more than $2.5 trillion in hedge fund and private credit assets. AIMA draws upon the expertise and diversity of its membership to provide leadership in industry initiatives such as advocacy, policy and regulatory engagement, educational programmes and sound practice guides. AIMA works to raise media and public awareness of the value of the industry. AIMA is committed to developing skills and education standards and is a co-founder of the Chartered Alternative Investment Analyst designation (CAIA) – the first and only specialised educational standard for alternative investment specialists. AIMA is governed by its Council (Board of Directors). For further information, please visit www.aima.org.

2 SEC, Proposing Release, Outsourcing by Investment Advisers, 87 FR 68816 (Nov. 16, 2022) (the "Proposing Release").

3 *See*, e.g., AIMA Letters to SEC, Extension request of comment periods for File Nos. S7-25-22 and S7-26-22 (Nov. 16, 2022) and Extension request of comment periods for File Nos. S7-04-22, S7-05-22, S7-06-22 and S7-08-22 (Mar. 3, 2022).

stakeholders the time to fully analyze, consider and comment on these rule proposals, including the time that it takes to study and analyze the market and economic implications of the proposals and identify possible unintended, negative consequences.

The complex array of front-, middle- and back-office services, and the division of labor between internal and external resources, that advisers rely on have been built, refined and strengthened over decades and should not be re-imagined through a 30 or 60-day comment period. The Commission forcing the industry to do so within such an unreasonable timeline is at odds with maintaining the orderliness and resiliency of the existing financial ecosystem. The structural, operational, legal and technological implications are significant. Injecting instability into that infrastructure risks creating negative outcomes for investors, including retail investors and retirement plans, and business disruptions for investment advisers and their clients. At a minimum, well-understood processes and operational plumbing will likely need to be re-designed and re-built. Behaviors of market participants will need to be re-considered and re-established, and there are reapportionments of economics and risk that must be considered.

That being said, we acknowledge that outsourcing is widely and increasingly used across the investment industry and the continued ability to outsource is important to our members. We also acknowledge that outsourcing can create additional risks that need to be identified, managed and mitigated where they cannot be avoided. But new prescriptive regulatory requirements around outsourcing should be imposed with care so they do not stifle outsourcing unnecessarily or require advisers to spend resources performing extensive due diligence without commensurate benefit to clients. Given the relatively small size of most of our member firms, compared for example, to a global bank or insurance company, the best way to access certain specializations or areas of expertise more cost-effectively is often to find high quality external service providers. Moreover, many investors request or require that advisers use third-party administrators and valuation service providers to ensure there is a separate set of eyes on key operational processes.

Our members understand that while certain functions can be outsourced, the responsibility and ownership remains with the adviser. Simply put, it is the advisers that will ultimately need to answer for any issues regarding non-compliance, and oversight of service providers has long been considered part of an adviser’s fiduciary duty.

As the Commission points out in the Proposal, advisers cannot waive their fiduciary duty, which is already broad in scope, and Section 215 of the Advisers Act of 1940, as amended (the “Advisers Act”), voids any contractual provision that purports to waive compliance with the Advisers Act or any rule, regulation or order thereunder. Thus, an adviser who has outsourced a function to a service provider remains liable for its obligations, from a fiduciary perspective and under the Advisers Act or other Federal securities laws. Advisers are also responsible for assuring that their services are rendered in a compliant manner. Advisers, therefore, already have every incentive to exercise appropriate diligence in selecting service providers and to undertake ongoing monitoring of the relationship without this new Proposal. And, in fact, advisers who outsource do perform appropriate diligence of service providers as a matter of course and, for critical service providers, such diligence and oversight are frequent and extensive. It is therefore unclear to us that a widespread problem even exists that requires any new regulatory requirements to solve, much less regulations that are prescriptive, burdensome and, in many ways, unclear. If it adopts this rule with the prescribed requirements proposed, the Commission runs the risk of creating more problems and increased costs which could result in smaller advisers and service providers being unable to continue their businesses. Moreover, the prescriptive requirements in the Proposal will increase costs because existing procedures and agreements will have to be renegotiated to be compliant even if that does not reduce risk versus the status quo and advisers will lose flexibility to take a risk-based and commercially-viable approach to negotiating diligence and contract terms.

The fiduciary obligations of advisers, existing rules applicable to advisers and funds, the modern technological context and commonly employed sound practices, not to mention other existing rules, have already resulted in advisers and funds implementing reasonably designed outsourcing practices and vendor management solutions that are protective of investors and more readily implemented by advisers and service providers in light of the individual nature of their businesses and services. AIMA has published its own guide to sound practices for Outsourcing by Investment Managers[4] and a related illustrative questionnaire for the due diligence of outsourced service providers.[5]

Under the Proposal, the Commission would impose expansive new regulatory requirements on an approximately $100 trillion industry, forbidding advisers from outsourcing certain services or functions without satisfying prescriptive and burdensome requirements. These burdens would not only be borne by advisers to investment companies and other institutional and retail clients,[6] but also by the broader population of service providers to the financial services industry. The Proposal will significantly increase the burdens imposed on advisers of any size, particularly in that they will have to expend financial and human resources to comply with the new requirements, if adopted. But, they will be particularly onerous for smaller advisers, including minority and women-owned advisers, especially when added to the cumulative burdens of other recently adopted and proposed rulemakings. Service providers will also be impacted by increased costs. If adopted, the proposal will result in barriers to entry for both advisers and service providers. Such barriers to entry will, no doubt, result in decreased competition, increased pricing and diminished innovation.

As the Commission itself notes in the Proposal: "Excessive oversight can result in costs to the adviser, and potentially its clients, that outweigh the intended benefits."[7] We believe that a more risk-based approach to the oversight of service providers would be appropriate instead of the proposed prescriptive regulatory requirements. By contrast to the Proposal, the National Futures Association

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4 *See* AIMA Guide to Sound Practices for Outsourcing by Investment Managers (Feb. 8, 2019).

5 *See* AIMA DDQ for Outsource Service Providers (Feb. 7, 2019).

6 Over time, fees charged to clients and investors could also increase if the proposed rule is adopted.

7 Proposing Release, *supra* note 2, at 68818.

("NFA") guidance regarding its members' supervisory obligations related to third-party service providers[8] is less onerous, more principles-based and consideration is more appropriately given to an individual firm's size, operations and risk tolerance and it is a flaw in the economic analysis to have not considered this interpretation. Even so, we believe as a practical matter that the NFA's and AIMA's industry guidance is no less protective than the Proposal.

We also believe that the Proposal would unnecessarily divert the Commission's resources from the protection of retail investors towards the protection of sophisticated, knowledgeable investors who retain and/or have access to professional advisors in connection with their investments in private funds. These investors already have robust protections under Federal securities laws, including, but certainly not limited to, the fiduciary duties that advisers owe to their clients under the Advisers Act. Further, we believe that creating a new rule under the anti-fraud provisions of the Advisers Act, that is likely to be construed in a strict liability context rather than a "reasonably designed policies and procedures" context, is inappropriate.

Finally, under the Proposal, advisers would be required to comply with the new regulatory requirements starting ten months following the effective date of the rule. We believe that this is a very aggressive and unrealistic compliance period, particularly in light of the number of other proposed rules – and adopted new rules – approved by the Commission in the past year, as well as the length of time it might take for advisers to be carrying out reviews and finding, negotiating with and then engaging new outsourced service providers. The compliance period also does not account for the endless permutations of advisers and service providers that will need to simultaneously negotiate new contractual terms and conduct additional due diligence.

Our members have drawn our attention to a number of concerns with the Proposal, which are outlined in detail in the Annex.[9] We would be happy to elaborate further on any of the points raised. For further information please contact Jennifer Wood, AIMA's Global Head of Asset Management Regulation & Sound Practices, by email at [redacted]

Yours sincerely,

Jiří Król
Deputy CEO, Global Head of Government Affairs

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8 *See* NFA Interpretive Notice on Members' Use of Third-Party Service Providers (Sept. 30, 2021).

9 Given the importance of the Proposal and the relatively short comment period afforded, we reserve the right to supplement this comment letter with additions to offer further commentary on certain aspects of the Proposal.

Cc: The Honorable Gary Gensler, Chair
The Honorable Hester M. Peirce, Commissioner
The Honorable Caroline A. Crenshaw, Commissioner
The Honorable Mark T. Uyeda, Commissioner
The Honorable Jaime Lizárraga, Commissioner
Mr. William Birdthistle, Director, Division of Investment Management
Mr. Dan Berkowitz, General Counsel

ANNEX

I. Advisers are already required to conduct due diligence on their service providers in connection with general fiduciary duty.

The Proposal is unnecessary because there are no gaps in the currently applicable requirements that need to be filled in this manner. Furthermore, the SEC has not identified a gap or a persistence of compliance failures that justify this Proposal.

Advisers today are subject to a number of existing rules and regulations which indirectly address the oversight of an adviser's service providers. For instance, rule 206(4)-7 under the Advisers Act requires advisers to consider, among other things, their regulatory obligations and formalize policies and procedures reasonably designed to prevent violation of the Advisers Act. Furthermore, rule 38a-1 under the Investment Company Act of 1940, as amended (the "Investment Company Act"), requires certain compliance procedures and practices by registered investment companies including board approval of the policies and procedures of each adviser, principal underwriter, administrator and transfer agent of the fund. NFA Compliance Rule 2-9 places a continuing responsibility on every member to diligently supervise its employees and agents in all aspects of their futures business.[10] Advisers to registered investment companies might also consider the risks of service providers when valuation agents or pricing services are engaged for purposes of complying with rule 2a-5, also known as the valuation rule, under the Investment Company Act.

The Proposal does not cite a wave of enforcement actions demonstrating that advisers are ignoring their obligations. In fact, the Proposal cites one enforcement action against an adviser regarding guidelines from a third-party subadviser, but in this case, the adviser ignored several existing legal obligations, and there is no explanation from the Commission as to how the overlay of a prescriptive outsourcing rule would have altered the individual adviser's conduct.

An adviser who has outsourced a function to a service provider remains liable for its obligations, including under the Advisers Act or other Federal securities laws. Advisers' fiduciary duty comprises a duty of loyalty and a duty of care, the latter of which includes providing investment advice in the best interest of the client, based on the client's objectives. It is therefore unclear whether such new prescriptive regulatory requirements solve a problem that currently exists with advisers. As the Commission points out in the Proposal, advisers cannot waive their fiduciary duty, which is already broad in scope. Prescriptive requirements could run the risk of creating more problems, such as inconsistent applications of the new requirements by advisers.

The fiduciary obligations of advisers, existing rules applicable to advisers and funds, the modern technological context and commonly employed sound practices, not to mention other existing rules, already require advisers and funds to implement reasonably designed outsourcing practices and

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10 *See* NFA Interpretive Notice on Compliance Rule 2-9 (Jan. 1, 2020).

vendor management solutions appropriate to their businesses. AIMA has published its own guide to sound practices for Outsourcing by Investment Managers[11] and a related illustrative questionnaire for the due diligence of outsourced service providers.[12] This guidance offers a proportionate approach, which is important given the wide range of advisers in terms of size and complexity, as well as a more outcome-focused approach also giving firms greater flexibility to adapt and innovate.

We believe that advisers are already required to conduct due diligence on their service providers in connection with general fiduciary duty enforceable under Section 206 of the Advisers Act. Moreover, where an adviser fails to fulfill its fiduciary duty to clients or comply with the Advisers Act and other Federal securities laws, its conduct may result in potential liability under the antifraud provisions of the Federal securities laws or to its clients on either contractual or fiduciary grounds. As the Commission pointed out in the Proposal, outsourcing a particular function or service does not change an adviser's obligations under the Advisers Act and other Federal securities laws. In addition, the adviser is typically responsible for the advisory services through an agreement with the client that represents or implies the adviser is performing all the functions necessary to provide the advisory services. Even if the adviser outsources functions, it remains liable for its obligations, including under the Advisers Act, the other Federal securities laws and any contract entered into with the client.

II. The broad definition of "covered function" is vague and could run the risk of creating more problems, such as inconsistent applications of the new requirements by advisers.

We believe that, despite the references in the Proposal regarding the Commission's views, advisers may still find the broad definition of "covered function" vague and open to interpretive challenges.

In certain instances, it will be difficult for advisers to determine whether or not a covered function meets the two elements: (1) those necessary for the adviser to provide its investment advisory services in compliance with the Federal securities laws; and (2) those 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.

Determining exactly what is or is not "necessary" in terms of 'a function that is necessary for the provision of advisory services' could prove difficult. For example, legal counsel could be reasonably viewed as a covered function under the proposed definition, even though it is unlikely that advisory clients expect the adviser to oversee its legal counsel. Another example is an adviser who hires a provider to assist in the initial preparation of the Form PF but ultimately does the final review and filing itself. Such an adviser may, on these facts, be challenged in deciding whether the provider is a service provider performing a covered function. Such interpretative challenges could lead to advisers unnecessarily spending time and resources to the detriment of other responsibilities. The Commission confirms that covered function does not include clerical, ministerial, utility or general

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[11] *See* AIMA Guide to Sound Practices for Outsourcing by Investment Managers (Feb. 8, 2019).
[12] *See* AIMA DDQ for Outsource Service Providers (Feb. 7, 2019).

office functions or services. It might be helpful to better define such functions or services to avoid inconsistent application of the rule and to draw better lines between firms providing inputs to allow the adviser to perform its own covered functions (e.g., the Form PF consulting described above, Bloomberg terminals, external legal counsel) and firms engaged to actually perform the covered function (e.g., subadvisers). See section III below.

Faced with the Proposal and the foreseeable strict liability enforcement of it, advisers are likely to err on the side of caution and treat each outsourced relationship as a covered function rather than taking a risk-based approach, which would significantly increase the costs of compliance, in terms of both monetary budgets and expanded working hours. This is especially so given that that failure to satisfy the oversight and documentation requirements dictated by the Proposal could be charged as fraud under the Advisers Act.

However, there will clearly be some services or functions that should not be viewed as critical to the functioning of the adviser and require compliance with the new rules. We believe the Commission should better define what is actually an investment advisory function and what is not. Advisers may have to resort to engaging consultants, outside counsel and other experts to determine which third-party service providers meet this definition. If advisers interpret "covered functions" too conservatively, they may end up spending time and money unnecessarily performing extensive due diligence when it is not required.

Finally, the “facts and circumstances” analysis of not only the “what” but also the “when” and “how” a covered function exists creates a fair amount of ambiguity and could result in the Proposal, if adopted, being broadly and inconsistently construed with the benefit of hindsight.

III. The Proposal should clearly distinguish between third-party vendors and outsourced service providers.

The Proposal has not sufficiently differentiated between outsourced service providers and third-party vendors. In other words, an adviser using a technology provider for fund administration as opposed to an adviser buying a data set . For example, investment research and data analytics tend to be *purchased* as opposed to *outsourced* in the common sense. We believe there is a need to clarify the distinction between purchasing a product or outsourcing a service or a function to a service provider. Producing a tool or product to support an adviser performing a function (e.g., client dashboards, Bloomberg terminals, Office 365) is not the same as performing a function in place of an adviser. It is also unclear whether OMS (Order Management System), PMS (Portfolio Management System) and EMS (Execution Management System) software is outsourcing especially if it is not bespoke to an individual adviser.

IV. Compliance with these ongoing, prescriptive requirements could prove extremely burdensome, particularly for smaller advisers who often have a need to outsource certain of their functions for quality and efficiency.

The onerous and prescriptive requirements in the Proposal would be greatly impactful to advisers of any size and business profile, particularly in that they will have to expend financial and human resources to comply with the new requirements, if adopted. Moreover, they will be particularly onerous for smaller advisers, especially when added to the cumulative burdens of other recently adopted and proposed rulemakings. Service providers will also be impacted by increased costs. If adopted, the proposal will result in barriers to entry for both advisers and service providers. Such barriers to entry will, no doubt, result in decreased competition, increased pricing and diminished innovation.

As the Commission itself notes in the Proposal, "Excessive oversight can result in costs to the adviser, and potentially its clients, that outweigh the intended benefits."[13] By contrast to the Proposal, the NFA guidance regarding its members' supervisory obligations related to third-party service providers[14] is less onerous, more principles-based and consideration is more appropriately given to an individual firm's size, operations and risk tolerance and it is a flaw in the economic analysis to have not considered this interpretation. Even so, we believe as a practical matter that the NFA's and AIMA's industry guidance is no less protective than the Commission's Proposal, especially given the current requirements under the Advisers Act.

One compliance issue advisers will face because of the Proposal is convincing their service providers to provide reasonable assurances that they have processes or systems for keeping records that meet the Advisers Act recordkeeping requirements. This will necessarily require service providers, many of whom are domiciled in other parts of the world or who may not primarily service the investment funds industry, to take notice of requirements which they are not otherwise subject to themselves or which differ significantly from local requirements. Requiring service providers who keep electronic records on behalf of investment advisers to provide access to these records to Commission staff will also be problematic for service providers who are not otherwise subject to the jurisdiction of the Commission or are subject to regimes that place limits on the movement of data. These service providers could ostensibly be subject to conflicting local laws around data privacy impacting their ability to provide access to the Commission's staff. It is unclear how the Commission's goals are not equally served by having recourse to the adviser directly rather than requiring access to the service provider's records. Moreover, satisfying the six prescribed elements may prove challenging to certain advisers with respect to service providers for which there is little transparency, easy accessibility or competition (e.g., mainstream cloud services). In some cases, security considerations could make additional transparency itself a risk that the service provider is unwilling to take.

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13 Proposing Release, *supra* note 2, at 68818.

14 *See* NFA Interpretive Notice on Members' Use of Third-Party Service Providers (Sept. 30, 2021).

We also believe it would be overly burdensome to require an adviser to obtain a third-party expert to oversee a service provider given that such a requirement could result in the need to subsequently obtain a third-party expert to oversee the third-party expert and so on and so forth.

Moreover, complying with such a broad and prescriptive new set of requirements could prove difficult for advisers if service providers are unwilling or unable to renegotiate contractual terms, including, in cases such as third-party recordkeepers, consent to ill-defined obligations to assist in compliance, and submission to a detailed audit of the service providers' books and records by the adviser, as suggested in the Proposal. Any compliance efforts will also likely require additional resources and significantly increased costs for advisers.

We expect this Proposal will have the greatest impact on smaller advisers, including minority and women-owned advisers, and service providers and contribute to existing industry trends towards consolidation, driven in part by the ability of larger firms to leverage technology, centralized operations and compliance infrastructure. This concern is exacerbated by the cumulative impact of the Commission's wave of newly-proposed regulations for advisers, each of which alone would significantly increase costs and the need for increased staff. If adopted, the proposal will result in barriers to entry for both advisers and service providers. Such barriers to entry will, no doubt, result in decreased competition, increased pricing and diminished innovation.

V. An exception for outsourcing to SEC-registered advisers or other service providers that are themselves subject to regulation under the Federal securities laws.

We believe that SEC-registered advisers performing sub-advisory services should be excepted from the scope of the proposed rule because an SEC-registered subadviser would already be subject to its own compliance with the Federal securities laws, for those services. However, should they be included in the scope of a final rule, then we believe that a subadviser engaged by the fund should not be treated as a service provider given that an adviser has not retained the subadviser in these cases.

VI. Concerns with the Proposal to pursue service providers to agree to a negligence standard.

The definition of covered function appears to extend the simple negligence standard envisioned by the Commission's proposed Private Fund Adviser Rule[15] to all outsourced service providers of the investment manager. This will be problematic for all advisers, but particularly so for new, small and emerging managers and in many cases, where the service provider is not beholden to the asset management community or where U.S. rules conflict with non-U.S. rules on financial services

[15] SEC, "Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews", Rel. IA-5955 (Feb. 9, 2022) (the "private fund adviser proposal").

outsourcing or are less well understood. Currently, most third-party service providers contractually require advisers to hold them harmless from liability at a "gross negligence" standard.

We are concerned that the Commission expects advisers to negotiate with service providers a negligence standard or certain assurances around liability. It may prove impossible for an individual adviser to compel outsourced service providers to agree to include such a clause in the written agreement, especially where the service provider is not reliant on U.S. registered investment advisers for a significant portion of their turnover. Effectively prohibiting advisers from doing business with anyone who rejects the simple negligence standard means effectively reducing, or even eliminating, the pool of available outsourced service providers to the asset management community or significantly increasing the risk borne by the adviser. This could exclude advisers from sourcing necessary expertise in a particular geographic market or asset class. Alternatively, some service providers may be willing to accept the simple negligence standard in exchange for a material price increase that compensates for the additional risk, which would ultimately increase costs for investors.

VII. An exception for affiliates from the definition of "service provider".

One of the primary concerns with the Proposal is the inclusion of affiliates. We would urge the Commission to include an exception for affiliates from the definition of "service provider". The Commission's proposed carve-out for supervised persons, as defined in 15 U.S.C. 80b-2(a)(25) of the Advisers Act is not sufficient. This definition is limited to persons "who provide[] investment advice on behalf of the investment adviser".[16] But it is not unusual for a meaningful portion of an adviser's employees to <u>not</u> be providing investment advice. This might include most, if not all, back-office functions such as accounting, compliance and client services. Although they are subject to an adviser's supervisory system, they are not supervised persons per se and therefore could fall within the proposed rule.

For example, it is common for employees of advisers (particularly advisers to large or multi-national funds) to sit in a legal entity that is separate from the registered entity. This is a matter of corporate formality, primarily for administrative and tax reasons (for example, it enables advisers to separate U.S. and non-U.S. employees for tax and accounting purposes). Employees are still treated as "persons associated with" the adviser and are subject to the adviser's supervisory control system. We do not believe that there is a rational basis for treating services provided by these employees as "outsourced" under the Proposal. However, the Proposal suggests that because these employees operate out of a distinct legal entity, they could then fall under the definition of "service provider" performing a covered function.

For these reasons, we strongly believe that affiliates should be excluded from the Proposal. At minimum, the Commission should properly tailor the rule to the types of affiliated relationships the

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16 Proposing Release, *supra* note 2, at 68823.

Proposal indicates it is concerned about (i.e., affiliated service providers where the adviser has limited control or transparency).

VIII. Distinction needs to be drawn between adviser responsibility and fund responsibilities.

We also advise that distinction is drawn between adviser responsibility and fund responsibilities, for example, in administration and valuation. In order to understand the full coverage of the Proposal, an adviser would need to review all service providers and determine which ones are retained by the adviser, retained by the client or by both. In some circumstances, it might be unclear and will be complicated to determine whether it is in or out of scope. There is a lack of clarity as to whether the legal engagement of the service provider by the client will be sufficient to take the relationship outside the scope of a "covered function", where the function provided by the service provider might otherwise meet the two prongs of the definition of "covered function". The Commission cites a custodian as an example of a service provider that would be out of scope because it has been independently selected and retained through a written agreement directly with the client, but in circumstances where a custodian is *de jure* selected by the investment adviser and potentially engaged by an investment adviser-affiliated general partner on behalf of a limited partnership, the Commission might be inclined to consider this a covered function. As a result, two similarly situated service providers would be treated differently by virtue of structural factors.

Moreover, where a rule requires that an adviser ensure something is done, like a fund financial statement audit under the proposed Private Fund Adviser Rule, clarity is needed about whose responsibility that is and how this outsourcing proposal then applies. In this example, an adviser cannot be the party engaging the auditor due to independence requirements. Moreover, an adviser cannot outsource anything the fund has not engaged it to do. Therefore, in this instance, we believe the best analysis is that the Proposal would not apply. However, given that the private fund adviser proposal applies to the adviser rather than the fund, there is a potential grey area that we would like to see resolved specifically in the adopting release.

Finally, the formalization of oversight requirements as fashioned in the Proposal could also diminish independence of certain service providers. The imposition of an oversight regime for service providers who have been retained to be independent of the investment adviser could diminish the appetite of the service provider to act in an independent manner which might be contrary to the interest of the investment adviser, for fear of jeopardizing the engagement, which could be contrary to the interests of investors.

IX. There could be circumstances in which an adviser might determine that abrupt termination was reasonably necessary to protect clients.

The provision requiring an adviser to obtain reasonable assurance for orderly termination of the performance of a covered function should be revised to permit advisers to exercise their judgment in certain cases. For example, a service that is readily available and/or which would not result in a significant risk in the event of transition should not need to meet this reasonable assurances requirement.

Furthermore, we think it would be reasonable to provide advisers with a safe harbor during periods where an adviser has determined to transition a covered function from one service provider to another. In instances where the adviser makes a determination that it no longer remains appropriate to outsource the covered function to that service provider, the Commission should provide a 120-day safe harbor to allow for advisers to transition a covered function from a service provider, as an orderly transition may require a period of overlapping services and due diligence must be performed before the new service provider can be engaged.

X. Difficult to ensure compliance with certain aspects of the proposed monitoring requirement.

The new rules and any guidance should allow sufficient latitude for advisers to make determinations as to when, where and how to diligence and monitor service providers based on the adviser's view as to the nature of the risks associated with the particular service or service provider. For example, assuring that there is access to business premises can be a challenge for firms, especially where the regulated entity will be a relatively small client to the service provider and/or where such access itself creates risks (e.g., cloud computing). Requiring advisers to conduct onsite visits of service providers on a periodic basis with physical access to where data is stored may make it impossible for advisers to use public cloud services. We therefore consider that data centres should be specifically carved out of the references to onsite visits in the right of access requirements or the right of physical access to data centres should be substituted for a right of access to the relevant systems information. In other words, seeing racks of blinking lights is of little use but being able to see infrastructure diagrams and setup might be useful. Increasingly, physical infrastructure is being replaced with software-defined infrastructure so there is nothing to actually see – or it could be split over multiple locations on shared physical infrastructure.

Advisers might not always be well-positioned to determine whether the service provider has any subcontracting arrangements that would be material to the performance of the covered function. Although advisers may ask service providers about their subcontracting arrangements, the level of detail the service providers are willing to provide is not often sufficient for the regulated firms to make any truly informed conclusions about potential risks that may exist.

XI. The proposed amendments to Form ADV are intended to enhance the Commission's ability to oversee advisers but could unnecessarily breach confidentiality provisions set into commercial agreements.

We believe that the Form ADV disclosure could unnecessarily breach confidentiality provisions that are a part of commercial agreements. Making disclosures to investors in an offering memorandum is different from making such disclosures to the entire marketplace as would be the case with an ADV requirement. We would instead support disclosure being made to clients and investors through other means and an outsourcing log maintained for SEC inspection instead of requiring disclosure on Form ADV.

We also disagree that having identifying information for each listed service provider would help the Commission to consider the potential effects in the event of an industry wide failure by a particular service provider. Some advisers will determine that a particular service is not a covered service while others might over-report services that are not covered due to differing assessments of risk and materiality of the service or based on a concern that the imprecise definitions in the Proposal could result in the adviser being second-guessed having omitted a service provider if there is even a faint argument that the service is a covered service. This could give the Commission a skewed view of the actual reality.

XII. Overlap with other new proposed rules on cybersecurity risk management and ESG requirements could be problematic.

The Proposal will cause particular problems where it overlaps with the Commission's proposed cybersecurity risk management and ESG requirements.[17] For example, it is not clear how an adviser is supposed to deal with the outsource-related requirements of the cybersecurity risk management requirements in addition to these new proposals. For example, when an adviser hires third parties with the requisite cybersecurity expertise, delegates cybersecurity management responsibilities to a subadviser or has third-party cyber audits undertaken. Furthermore, we foresee difficulty if an adviser is expected to treat ESG data providers or ESG rating services as outsource providers. This is particularly problematic as data availability and ESG resources can be challenging.

XIII. The Commission should set a compliance date of at least 30 months from the publication of a final rule's publication in the Federal Register.

We believe that a ten-month transition is an unrealistic compliance period, particularly in light of the number of other proposed rules – and adopted new rules – approved by the Commission over the past year. If the Proposal is adopted, advisers would be required to apply the new requirements to any engagement of new service providers made on or after the compliance date as well as conduct ongoing monitoring requirements to existing engagements beginning on the compliance date. The Proposal would be greatly impactful to advisers of any size, but compliance within this time period may prove particularly challenging for smaller advisers with fewer resources and personnel. The compliance period also does not account for the endless permutations of advisers and service providers that will need to simultaneously negotiate new contractual terms.

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[17] SEC, "Cybersecurity Risk Management for Investment Advisers, Registered Investment Companies, and Business Development Companies", Rel. IA-5956 (Feb. 9, 2022) and "Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices", Rel. IA-6034 (May. 25, 2022).

We would strongly encourage the Commission to factor in the additional resources and time that will likely be required for advisers to comply with these new requirements. For example, this could include an adviser needing to review and revise its existing practices, hiring new personnel, choosing to switch service providers in response to the Proposal and multiple other factors. We would therefore encourage the Commission to introduce a 30-month compliance period for all advisers or a tiered timeframe for different requirements to better facilitate and ensure an effective and orderly implementation of the new requirements, assuming the Proposal is adopted largely as proposed. If the Proposal is amended to be made more principles-based relying on risk-based assessments, less than 30 months could be sufficient but, in all events, more than 10 months will be necessary.

We believe that a final rule should include a provision that excludes an adviser's existing fixed-term engagement with a service provider that occurred prior to any compliance date of the proposed rule.

We would also recommend that the Commission consider providing an exception for service provider engagements that are short-term in nature (for instance, less than one year).