

MEMO# 34733

December 23, 2022

ICI Files Comment Letter with the SEC on Outsourcing by Investment Advisers Proposal

[34733]

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TO: ICI Members

SEC Rules Committee SUBJECTS: Compliance

Intermediary Oversight

Investment Advisers

Operations

Recordkeeping

Risk Oversight RE: ICI Files Comment Letter with the SEC on Outsourcing by Investment Advisers Proposal

On December 23, 2022, the ICI filed a comment letter with the Securities and Exchange Commission on its proposal entitled "Outsourcing by Investment Advisers."[\[1\]](#) The SEC has proposed a new rule, Rule 206(4)-11, under the Investment Advisers Act of 1940 (the "Advisers Act"), that would prohibit registered investment advisers from outsourcing certain services or functions without first meeting specified requirements. The proposed new rule seeks to prescribe an adviser's initial and ongoing due diligence oversight obligations, as well as periodic monitoring and reassessment of a service provider's performance. The SEC has also proposed revising: (1) Form ADV to require advisers to disclose certain information about their service providers; and (2) Rule 204-2 to require advisers to maintain records documenting compliance with the new rule as well as new provisions requiring due diligence and monitoring of third-party recordkeepers.

The ICI recommended that the SEC abandon this Proposal. We concur with Commissioner Peirce that the Proposal "is neither statutorily grounded nor protective of investors."[\[2\]](#) Attempting to adopt an anti-fraud rule "repackaging existing fiduciary obligations into a new set of prescriptions for investment advisers"[\[3\]](#) is unnecessary, burdensome, and something we cannot support. Our comment letter is attached and is summarized below.

Executive Summary

The SEC and staff have a long history of taking actions to assist registrants in fulfilling their regulatory responsibilities.[\[4\]](#) Notwithstanding this history, the SEC elected to address

alleged concerns related to advisers overseeing service providers in a prescriptive and blunt manner: by promulgating a new anti-fraud rule. Compounding our concerns with a new anti-fraud rule is the fact that the Proposal's approach to regulating outsourcing arrangements reflects serious flaws. Based on the Proposing Release, the SEC does not appear to be fully informed of the operational processes and interactions between registered investment advisers and their service providers. The Proposal is overly broad, allows for arbitrary application and second guessing, and raises significant and highly serious cybersecurity concerns. Moreover, the Proposal includes requirements that are outside the SEC's authority under the Federal securities laws and the cost-benefit analysis is wholly inadequate. As a result, the SEC should not move forward on this Proposal.

We oppose the SEC proceeding with this Proposal for the following reasons:

- There is no evidence that this Proposal is needed;
- Current law, including advisers' fiduciary duty, appropriately addresses the SEC's concerns, thereby obviating the need for this targeted and prescriptive rule as the SEC has sanction (and examination) authority under existing law;
- The SEC should have developed more information to gain a better understanding of the advisory ecosystem and service provider engagement before considering what, if any, actions were appropriate. The Proposing Release demonstrates significant misunderstandings of, and would significantly disrupt, advisory and fund operations. For example:
 - Proposed Rule 206(4)-11 is vague, disrupting and complicating how advisers oversee their service providers;
 - Proposed Rule 206(4)-11 would create duplicative costs and impose barriers of entry; and
 - The Proposal introduces substantial and serious cybersecurity risks due to the assurances it would require from cloud data providers and the public Form ADV disclosure;
- The Proposal attempts to expand the SEC's jurisdiction beyond its Congressional mandate to persons outside its authority;
- Proposing Rule 206(4)-11 as an antifraud rule is inappropriate and beyond the SEC's authority; and
- The Proposal's costs and burdens are not adequately identified or considered by the SEC.

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Notes

[1] See Outsourcing by Investment Advisers, Advisers Act Release No. 6176 (Oct. 26, 2022), available at <https://www.sec.gov/rules/proposed/2022/ia-6176.pdf> ("Proposal" or "Proposing Release"). For a summary of the Proposal, see ICI Memorandum No. 34328 (Oct. 28, 2022), available at <https://www.ici.org/memo34328>.

[2] See Hester M. Peirce, Commissioner, SEC, Outsourcing Fiduciary Duty to the Commission: Statement on Proposed Outsourcing by Investment Advisers (Oct. 26, 2022),

available at

<https://www.sec.gov/news/statement/peirce-service-providers-oversight-102622>.

[3] Id.

[4] See e.g., Guidance published by the SEC's Division of Investment Management, available at <https://www.sec.gov/investment/im-guidance-updates.html>; Guidance published by the SEC's Division of Examinations, available at <https://www.sec.gov/exams> (including yearly exam priorities memos and risk alerts). See also, e.g., Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers, Advisers Act Release No. 5325 (Aug. 21, 2019), available at <https://www.sec.gov/rules/interp/2019/ia-5325.pdf>; Commission Interpretation Regarding Standard of Conduct for Investment Advisers, Advisers Act Release No. 5248 (June 5, 2019), available at <https://www.sec.gov/rules/interp/2019/ia-5248.pdf>.

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