The Investment Lawyer
Covering Legal and Regulatory Issues of Asset Management
VOL. 30, NO. 3 • MARCH 2023

Investment Adviser Outsourcing Oversight Proposal

By Genna Garver

On October 26, the Securities Exchange Commission (SEC) kicked off its fall rulemaking season by proposing a new outsourcing oversight rule under the Investment Advisers Act of 1940, as amended (Advisers Act). The proposal came in response to the SEC's observations of increased outsourcing and related risks of client harm, which the SEC believes are insufficiently addressed by its existing regulatory framework.

Leading up to the proposal, SEC Chair Gary Gensler was on the defense for his ambitious agenda and aggressive rulemaking activity.[1] The industry had been expecting a rulemaking season jam-packed with new SEC rule proposals and possible adoptions of rules proposed earlier in 2022. Indeed, Chair Gensler's agenda had approximately 50 projects, including, but not limited to: proposals for new rules related to the role of certain third-party service providers and the implications for the asset management industry;[2] amendments to the Advisers Act custody rule, further amendments to Form PF; and new rules regarding digital engagement practices for investment advisers.[3] Despite the Chair's ambition, the only new Advisers Act rule proposed in the fourth quarter was the new outsourcing oversight Rule 206(4)-11 along with its related amendments to the existing Advisers Act books and records Rule 204-2.[4]

The issuance of a single Advisers Act proposal signaled an agenda shift. Still, the outsourcing oversight proposal has been met with significant industry criticism for lack of evidence supporting the need for the rule and its redundancy with the existing regulatory framework.[5] The SEC stated in its proposing release that more needs to be done to protect clients and enhance oversight of advisers' outsourced functions–advisers cannot just "set it and forget it" when outsourcing.[6] Proposed Rule 206(4)-11 intends to create a consistent oversight framework for the industry and specific standards for which registered investment advisers conduct initial and periodic due diligence on third-party service providers. The proposal also includes related amendments to Form ADV to help the SEC quickly analyze the potential impact of a critical failure at a service provider. The SEC also proposed amendments to the Advisers Act books and records Rule 206(4)-2 to require specific conditions for all advisers using third parties to make and keep records required by the rule. Many of the proposed changes are in fact duplicative of existing requirements and advisers' fiduciary duty, which cannot be waived or delegated.[7]

What's the Problem?

Service provider risk is certainly not new to the asset management industry. As the recent success of the Netflix docuseries, *Madoff: The Monster of Wall*

Street, reminds us, it's been over a decade since the industry was rocked by arguably its worst service provider due diligence failure. Since then, the SEC has implemented a number of reforms to address the risks associated with fiduciaries relying on third parties to support their businesses, including enhancing safeguards for investors' assets; revamping its approach to examinations and revitalizing enforcement; establishing a successful whistleblower program; and enhanced licensing, education and oversight for 'back-office' personnel.[8] Those Madoff reforms, however, were specifically targeted at vetting out fraud and misappropriation. The proposed outsourcing rules are intended to address additional service provider risks, including those stemming from providers acting in good faith.[9]

Still, many industry participants, including some of the SEC's own Commissioners, have characterized the SEC's rulemaking as a solution in search of a problem.[10] Commissioner Peirce questioned, "What precisely is the problem this proposal is trying to correct?"[11] Commissioner Uyeda also questioned whether "there is any observable problem related to investment advisers' oversight of service providers that necessitates the blanket imposition of specified oversight requirements."[12] Commission Uyeda also stated that, "the observations cited in the proposing release as a basis for proposing this rule do not appear to describe service provider failures that would have been prevented had the rule been in effect."[13] Even if we are to assume the proposal release includes sufficient evidence to support to additional rulemaking, no amount of diligence would be sufficient alone to result in zero failures.

Proposed Rule 206(4)-11

As stated in the proposed rule release, the SEC believes, "it is a deceptive sales practice and contrary to the public interest and investor protection for an investment adviser to hold itself out as an investment adviser, but then outsource its functions that are necessary to its provision of advisory services to its clients without taking appropriate steps to ensure that the clients will be provided with the same protections that the adviser must provide under its fiduciary duty and other obligations under the Federal securities laws."[14] While the fiduciary duty is enforceable by the antifraud provisions of the Advisers Act, the SEC makes it clear that disclosure alone will not address this deception—it would be misleading, deceptive, and contrary to the public interest for an adviser to outsource without having effective and sufficient oversight over the service provider "so as to fulfill the adviser's fiduciary duty, comply with the Federal securities laws, and protect clients from potential harm."[15] As discussed below, the industry's response can be boiled down to the question: How responsible should advisers be for failures of third parties?

Scope of the Proposed Rule

If adopted as proposed, proposed Rule 206(4)-11 would apply to SEC-registered investment advisers that outsource one or more "Covered Functions" to "Service Providers."

Service Providers

Proposed Rule 206(4)-11(b) would define the term "Service Provider" to mean a person or entity that:

- Performs one or more Covered Functions; and
- Is not a supervised person[16] of the investment adviser.

Commenters have generally expressed concern over the breadth of this definition, especially its inclusion of advisory affiliates, which often provide back-office support to advisers and which may be subject to their own regulatory regime (that is, affiliated broker-dealers).[17] Some have requested clarification on the scope of the definition covering not only providers performing Covered Functions for investment advisers, but also those performing Covered Functions for investment adviser representatives.[18] The proposed definition also does not make any distinction for providers performing services for dual registrants.

Unless the SEC provides clarification in the final rulemaking process, advisers could be left with making their own determinations that could be subject to scrutiny upon SEC examination. It is possible the SEC Staff could provide additional guidance following a final rule, but the current SEC Staff has been taking the view that rules should stand on their own (or together with the text of their adopting releases and FAQs). Taking this approach with rules that contain vague and ambiguous definitions stokes fears of enforcement referrals by SEC examiners who find an adviser's determination of its Service Providers too narrow. Even if the risk of regulation through enforcement was remote, examiners are incentivized to provide deficiencies to avoid misunderstandings that closing exams without deficiencies amounts to silence as acquiescence of otherwise deficient determinations.

Covered Functions

Under the proposed rule, whether a function is a "Covered Function" requires a facts and circumstances analysis. Functions that may be Covered Functions for one adviser may not be deemed Covered Functions for another adviser.[19] To fall within the scope of the definition of a Covered Function, the function would have to meet both of the following criteria:

1. A function or service that is necessary for the adviser to provide its investment advisory services in compliance with the Federal securities laws; and
2. 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.

For purposes of meeting the first prong of the proposed definition of Covered Function, in the proposing release the SEC stated it would "consider functions or services that are related to an adviser's investment decisionmaking process and portfolio management." Notably, clerical, ministerial, utility, general office functions and services are excluded from the definition of a Covered Function.[20]

Commenters have expressed concern that the scope of the definition of Covered Function is too vague and ambiguous.[21] The proposing release provides the following examples of what would be deemed Covered Functions, which seem to suggest the scope of the definition extends only to functions relating to the provision of investment advice:

- Relating to providing investment guidelines (including maintaining restricted trading lists);
- Creating and providing models related to investment advice;
- Creating and providing custom indexes;
- Providing investment risk software or services;
- Providing portfolio management or trading services or software;
- Providing portfolio accounting services; and
- Providing investment advisory services to an adviser or the adviser's clients.

However, the proposed definition of Covered Function is not expressly limited to functions that are directly related to providing advice with respect to the purchase or sale of securities. Given the industry's recent experience with implementing amended Advisers Act Rule 206(4)-1 (the Marketing Rule), advisers may be forced to take an overly broad approach to the outsourcing rules to avoid SEC examiners second-guessing their identification of Covered Functions and the possibility of enforcement. Taking an overly broad approach could unnecessarily drain compliance resources that could be used to manage more critical risk areas.

To highlight the types of relationships that could be captured by a broad application of the open-ended definition of Covered Functions, at least one commenter[22] provided the example of a law firm advising on matters relating to compliance with the Advisers Act. That type of relationship would not involve "outsourcing" or "delegating" the adviser's compliance function. Rather, law firms often provide advice regarding interpretation of the law and how an adviser could comply with it.[23] For example, advisers may find themselves engaging outside counsel to assist with their understanding of the definition of "Covered Functions," but the adviser will remain responsible for making its own determination in light of counsel's advice. Law firms could also assist with "mock exams," but that work does not replace an adviser's annual review required under Advisers Act Rule 206(4)-7.

Commenters are particularly concerned with the second part of the definition of "Covered Function" and the lack of guidance as to how advisers would evaluate the extent to which functions or services may be "performed negligently." It is unclear whether inclusion of this negligence standard means advisers would be liable for simple negligence of a Service Provider.[24]

Commenters have also urged the SEC to consider adopting a risk-based approach that would allow advisers the flexibility to tailor their practices to fit the types of service providers retained and the functions being performed.[25] It's uncertain how these requests will be met by the SEC given its recent shift from principles-based rules, such as the Marketing Rule, to favoring more prescriptive rulemaking.

Initial Due Diligence

Before engaging a Service Provider to perform a Covered Function, each SEC registered adviser would need to reasonably identify and determine through due diligence that it would be appropriate to outsource the Covered Function and that it would be appropriate to select that Service Provider by:

- Identifying the nature and scope of the Covered Function the Service Provider is to perform;
- Identifying, and determining how it will mitigate and manage the potential risks to clients or to the adviser's ability to perform its advisory services resulting from engaging a Service Provider to perform the Covered Function and engaging that Service Provider to perform the Covered Function;
- Determining that the Service Provider has the competence, capacity, and resources necessary to perform the Covered Function in a timely and effective manner;
- Determining whether the Service Provider has any subcontracting arrangements that would be material to the Service Provider's performance of the Covered Function, and identifying and determining how the investment adviser will mitigate and manage potential risks to clients or to the investment adviser's ability to perform its advisory services in light of any such subcontracting arrangement;
- Obtaining reasonable assurance from the Service Provider that it is able to, and will, coordinate with the investment adviser for purposes of the adviser's compliance with the Federal securities laws, as applicable to the Covered Function; and
- Obtaining reasonable assurance from the Service Provider that it is able to, and will, provide a process for orderly termination of its performance of the Covered Function.

A number of commenters expressed concern about the proposal's requirement for advisers to obtain certain reasonable assurances from Service Providers as listed above, including reasonable assurances that Service Providers are able to and will coordinate with the adviser for purposes of compliance with the Federal securities laws.[26] Commenters have criticized these requirements for not only ignoring the realities of private negotiating bargaining power, especially for smaller advisers, but also for effectively causing indirect regulation of these Service Providers who otherwise might be outside of the SEC's jurisdictional reach.[27]

Periodic Monitoring

If an adviser decides to outsource a Covered Function to a Service Provider, proposed Rule 206(4)-11 would require SEC registered advisers to periodically monitor the Service Provider's performance of the Covered Function and reassesses the retention of the Service Provider in accordance with the initial due diligence requirements discussed above and with a manner and frequency such that the investment adviser reasonably determines that it is appropriate to continue to outsource the Covered Function and that it remains appropriate to outsource it to the Service Provider.

As noted above, however, commenters have strongly supported the adoption of a principles-based approach, more consistent with current industry practice, allowing advisers to maintain tailored diligence programs based on their assessment of the risks associated with the services provided by a particular Service Provider.[28] Alternatively, heightened diligence and monitoring measures could be prescribed for those Service Providers performing critical operational functions.

Proposed Amendments to Advisers Act Books and Records Rule 204-2

The proposed amendments to Advisers Act Rule 204-2 related to proposed Rule 206(4)-11 would require SEC registered advisers to maintain the following books and records:

1. A list or other record of Covered Functions that the adviser has outsourced to a Service Provider, including the name of each Service Provider, along with a record of the factors, corresponding to each listed function, that led the adviser to list it as a Covered Function.

Requiring such detailed records without exception for obvious factors or materiality of the arrangement could significantly burden already strained compliance resources.[29] As we have seen with other rules, these types of books and records requirements could trip inadvertent violations where no actual harm is occurring. Smoke does not necessarily mean fire. If the SEC deems advisers to have inadequate records of the factors they considered for any particular Covered Fund, the adviser could be given a deficiency or potentially face enforcement for a books and records failure even where the adviser has otherwise satisfied its obligations with respect to outsourcing that Covered Function.

2. Records documenting the due diligence assessment conducted pursuant to Rule 206(4)-11, including any policies and procedures or other documentation as to how the adviser will comply with Rule 206(4)-11(a)(1)(ii) (requiring the adviser to identify, and determine how it will mitigate and manage, the potential risks to clients or to the adviser's ability to perform its advisory services resulting from engaging a Service Provider to perform the Covered Function and engaging that Service Provider to perform the Covered Function).

The requirement to maintain records of compliance policies and procedures, while specific to a particular subparagraph of the proposed rule, is redundant of current Rule 204-2(a)(17)(i), which requires advisers to maintain a copy of their policies and procedures formulated pursuant to the Advisers Act Compliance Rule 206(4)-7(a). Records of only one other policy is expressly required to be maintained under Rule 204-2: proxy voting policies and procedures formulated under Rule 206(4)-6, which predates the issuance of the Compliance Rule.[30]

3. A copy of any written agreement, including any amendments, appendices, exhibits, and attachments, entered into with a Service Provider regarding Covered Functions, each as defined in Rule 206(4)-11.

This requirement too would be redundant of Rule 204-2(a)(10), which requires advisers to maintain all written agreements (or copies thereof) entered into by the investment adviser with any client or otherwise relating to the business of such investment adviser as such. Given the proposed definition of a Covered Function, it seems all agreements for Covered Functions would relate to the business of the investment adviser as such. If, however, there are Covered Function agreements that would not be captured under the existing rule, the SEC should clarify the definition of Covered Function in the final version of the outsourcing rule to avoid confusion over its scope.

4. Records documenting the periodic monitoring of a Service Provider pursuant to Rule 206(4)-11.

As discussed above, the SEC has received comments regarding the potential increased burden on compliance professionals in managing these additional records requirements. Ironically, advisers may find themselves needing to outsource these compliance functions to manage their resources.

Retention Period

Pursuant to proposed Rule 204-2(e)(4), all of these four new categories of records would be required to be maintained in an easily accessible place throughout the time period during which the adviser has outsourced a Covered Function to a Service Provider and for a period of five years thereafter.

Requirements for Third-Party Recordkeepers

The proposed amendments would also require every investment adviser that relies on a third party to keep books and records required by the recordkeeping rule to conduct due diligence and monitoring of the Service Provider with respect to their recordkeeping, consistent with the due diligence requirements under proposed Rule 206(4)-11. The proposed amendments would require the adviser to obtain reasonable assurances that the third party will meet four standards that address the third party's ability to:

1. Adopt and implement internal processes and/or systems for making and/or keeping records on behalf of the adviser that meet the requirements of the recordkeeping rule as applicable to the adviser;
2. Make and/or keep records of the adviser that meet all of the requirements of the recordkeeping rule as applicable to the adviser;
3. With respect to electronic records of the adviser made and/or kept by the Service Provider, allow the adviser and SEC Staff to easily access through computers or systems during the required retention period; and
4. Make arrangements to ensure the continued availability of records of the adviser that are made and/or kept by the Service Provider that will meet all of the requirements of the proposed amendments as applicable to the adviser in the event that the Service Provider ceases operations or the relationship with the adviser is terminated.

Advisers may face stiff resistance to these requirements from recordkeeping Service Providers, especially those who are not offering industry specific services, such as cloud storage providers. In particular, those Service Providers will likely be concerned about providing access to a regulator with no jurisdiction to inspect or regulate its business. Similar to commenters' concerns with the "reasonable assurances" requirements in proposed Rule 206(4)-11's due diligence provisions discussed above, commenters expressed similar concerns with the cooperation that would be required under the proposed amendments to Rule 204-2.[31] Recordkeeping Service Providers may be unwilling to provide such "reasonable assurances" and risk charges of aiding and abetting an adviser's books and records rule violation for failing to meet the SEC's recordkeeping standards.

Proposed Form ADV Amendments: New Part 1 A, Item 7.C. and Related Section 7.C. of Schedule D

New Item 7.C. in Part 1A and Section 7.C. in Schedule D would require advisers to provide census-type information about service providers performing Covered Functions. While the proposed disclosures would help clients make informed decisions about retaining advisers, they also provide greater visibility for the SEC to identify potential risks and allocate exam resources. Specifically, the amendments would require registered advisers to:

- Identify each Service Provider that perform Covered Functions by both their legal name and primary business name;
- Identify whether each Service Provider is a related person;
- Provide the date they were first engaged to provide Covered Functions;
- Provide the location of the office principally responsible for the Covered Functions; and
- State whether they are related persons of the adviser.

Advisers also would have to clarify the Service Providers' services or functions by selecting from the following proposed predetermined categories of Covered Functions:

- Advisor / Subadvisor;
- Client Servicing;
- Cyber Security;
- Investment Guideline / Restriction Compliance;
- Investment Risk Portfolio Management (excluding Advisor / Subadvisor);
- Portfolio Accounting;
- Pricing;
- Reconciliation;
- Regulatory Compliance;
- Trading Desk;
- Trade Communication and Allocation; and
- Valuation.

With this information, the SEC can identify advisers' use of particular Service Providers that may pose a risk to clients and investors, such as in situations where the SEC learns that a service provider experiences a significant and ongoing disruption to its operations. However, all of this information would be publicly available if the proposed Form ADV amendments are adopted as proposed. A number of commenters expressed concerns with making this information available to the public, including concerns regarding the potential for increased cyberattacks against identified Service Providers.[32] Commenters also expressed concern over ambiguities with the enumerated categories and the potential for investor confusion regarding the extent of the role the identified Service Provider plays in supporting the adviser's functions.[33]

Another concern for consideration is the additional length of time this item will inflict on the Form ADV updating process. The proposing release indicates the amendments to Form ADV for new Item 7.C. and related Schedule D items would create an initial additional burden of only 1.5 hours (reflects estimate of 18 minutes per outsourced covered function x estimated average of 5 covered functions per adviser), with an annual amendment burden of only approximately 0.7 hours.[34] However, some advisers have hundreds of Service Providers, each of which may change from reporting season to reporting season based upon the adviser's ongoing monitoring, changes in the Service Provider's business and other factors. Compliance would be tasked with confirming the applicable business units have reviewed and updated their Service Provider disclosures. As we saw with the amendment creating Item 7.B. and related Schedule D, Item 7.B reporting, these additional sections can add significant amount of strain on compliance resources not necessarily reflected in the estimates included in the proposing release.

Proposed Compliance Date

Under the proposal, all advisers registered (or required to be registered) with the SEC must comply with the rule, if adopted, starting 10 months from the rule's effective date (compliance date). The rule would apply to all new Service Provider engagements made on or after the compliance date, while the ongoing monitoring requirements would apply to existing engagements beginning on the compliance date. However, the SEC has requested comment on whether the rule should provide an exclusion for such existing engagements, as well as for Service Provider engagements that are short term in nature (for example, less than three months).

Especially with lessons from the new Marketing Rule implementation fresh in minds, commenters generally are concerned about the relatively short, proposed compliance period.[35] Advisers faced a number of issues and disruptions implementing the Marketing Rule because of the need to coordinate with Service Provider, including with providers who are not subject to the SEC's jurisdiction or knowledgeable of the SEC's standards for registered advisers. The proposed outsourcing rule could require similar cooperation. Challenges with Marketing Rule implementation included ensuring third party manager fact sheets present performance information net of fees, and ensuring performance reports generated from third party investment analysis software include adequate disclosures, particularly those disclosures required for the presentation of hypothetical performance information. For the proposed outsourcing rules and amendments, advisers would need to update policies and procedures, due diligence and monitoring practices and related forms required to be maintained; implement all of those policies and procedures by conducting additional due diligence; as well as renegotiate their existing Service Provider agreements to obtain reasonable assurances and come into compliance within 10 months. A number of commenters also expressed concern that the short compliance period could exacerbate barriers to entry for small advisers and incentivize consolidation among both advisers and service providers.[36]

A number of commenters requested the final rule to include a grandfathering provision for existing Service Provider arrangements to avoid potential disruption in service to clients.[37]

Requests for Comments

The SEC requested comments on numerous aspects of the proposals, including whether the proposed rule should explicitly apply to index providers, model providers, valuation agents, or other Service Provider central to an adviser's investment decisionmaking process. The SEC also requested comments on whether the proposed rule should apply to Service Provider that an adviser retains on behalf of their clients, including clients that are registered investment companies or private funds (for example, third-party fund administrators and auditors). Particularly, the request for comment includes whether or not the SEC should provide an explicit exception from the proposed rule if a Service Provider engagement is approved in the case of a registered fund by the board, including a majority of the independent directors, or in the case of a private fund by a majority of the Limited Partner Advisory Committee (LPAC) or equivalent body.

The SEC Staff also requested comment on whether the rule should include an express provision that prohibits an adviser from disclaiming liability when it is not performing a covered function itself. This request appears to be a nod to the SEC's push to limit privately negotiated exculpation of liability provisions in investment advisory agreements, particularly in private fund agreements.[38] Indeed, the 2022 private fund rules proposal includes a prohibition on gross negligence standards.[39] Many private fund agreements and non-fund advisory agreements contain exculpation for third parties selected with reasonable care. Examples include:

- The Advisor will not be responsible for any loss incurred by reason of any act or omission of Client, Custodian, any broker-dealer or third-party investment Advisor selected with reasonable care.
- The Investment Manager will not be responsible for losses due to such mistakes, action, or inaction, or to the negligence, dishonesty, or bad faith of any employee, broker, or other agent of the Fund; provided that such employee, broker, or agent was selected with reasonable care.

At least one commenter expressed concern that the SEC would expect advisers to negotiate with service providers a negligence standard or certain assurances around liability, which would effectively reduce, or even eliminate, the pool of available outsourced service providers with necessary expertise, and ultimately increase costs to compensate for the additional risk assumed.[40]

Comments were due by December 27, 2022, giving the public just 62 days to respond at a time when many advisers were stretched thin with implementation of the new Advisers Act Market Rule 206(4)-1 and managing year-end. Despite the short comment period, over 90 comment letters were submitted and at least nine meetings were held with SEC officials.

With yet another jam-packed regulatory agenda for the first six months of 2023, the industry is bracing itself for the final rulemaking stage of these outsourcing oversight proposals. Because the current SEC agenda—the Fall 2022 "Reg Flex" Agenda—is based on information submitted by the SEC on October 7, 2022, the Outsourcing Rule is listed as being in the proposed rule stage with no indication of when the rule is expected to be considered for adoption. If adopted, the Commission will hopefully address the significant comments and questions submitted in response to its request and avoid confusion similar to what was left in the wake of the new Marketing Rule's adoption.

Ms. Garver is a partner at Troutman Pepper Hamilton Sanders LLP.

NOTES

1 *See* U.S. Senate Committee on Banking, House, and Urban Affairs, Hearing on Oversight of the U.S. Securities and Exchange Commission, Sept. 15, 2022.

2 While this agenda item appears to be the same subject matter as the outsourcing rule, the agenda items differ from the SEC's Spring 2022 "Reg Flex" Agenda and the Fall 2022 "Reg Flex" Agenda.

3 *See* Securities and Exchange Commission Agency Rule List - Spring 2022.

4 *See* Proposed rule: Outsourcing by Investment Advisers (sec.gov) (87 FR 68816).

5 *See* Comment Letter of National Society of Compliance Professionals (Dec, 21, 2022) (NSCP Comment Letter), Comment Letter of AssetMark Financial Holdings, Inc. (Dec. 27, 2022), and Comment Letter from Investment Company Institute (Dec. 23, 2022) (ICI Comment Letter).

6 87 FR 68816 at 68819.

7 *See* 87 FR 68816 at 68819 (*citing Commission Interpretation Regarding Standard of Conduct for Investment Advisers*, Investment Advisers Act Release No. 5248 (June 5, 2019), at 6–8 [84 FR 33669 (July 12, 2019)]) (discussing how an adviser remains responsible for the performance of its services and must act in the best interest of the client in doing so and cannot waive its fiduciary duty.) *See* also *id.* at 68863 (stating that it would be a breach of its fiduciary duty and deceptive for an adviser to outsource certain covered functions without conducting initial due diligence and ongoing oversight, particularly those related to its advisory services and compliance with the Federal securities laws.)

8 *See* The Securities and Exchange Commission Post-Madoff Reforms.

9 For example, if an adviser used a service provider for portfolio management functions that experienced a cyber incident, that could limit the adviser's ability

to monitor risks in client portfolios. 87 FR 68816 at 68822.

[10] *See* NSCP, Comment Letter from Cambridge Investment Research Advisors, Inc. (Dec. 27, 2022) (Cambridge Investment Research Advisors, Inc. Comment Letter) and Comment Letter from Kroll, LLC (Dec. 27, 2022) (Kroll Comment Letter).

[11] H.M. Peirce, 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-providersoversight-102622*.

[12] M.T. Uyeda, Statement on Proposed Rule Regarding Outsourcing by Investment Advisers (Oct. 26, 2022), available at *https://www.sec.gov/news/statement/uyeda-statement-service-providers-oversight-102622*.

[13] *Id*.

[14] 87 FR 68816 at 68819.

[15] *Id*.

[16] Advisers Act Section 202(a)(25) defines the term "supervised person" to mean any partner, officer, director (or other person occupying a similar status or performing similar functions), or employee of an investment adviser, or other person who provides investment advice on behalf of the investment adviser and is subject to the supervision and control of the investment adviser.

[17] *See* ICI Comment Letter, Comment Letter from Managed Funds Association (Dec. 20, 2022) (MFA Comment Letter) and Comment Letter from Alternative Investment Management Association (Dec. 19, 2022) (AIMA Comment Letter).

[18] *See* Cambridge Investment Research Advisors, Inc. Comment Letter.

[19] 87 FR 68816 at 68821.

[20] Proposed Rule 206(4)-11(b)(1).

[21] *See* Cambridge Investment Research Advisors, Inc. Comment Letter and ICI Comment Letter.

[22] *See* Comment Letter from BlackRock, Inc. (Dec. 27, 2022) (BlackRock Comment Letter).

[23] *See* MFA Comment Letter.

[24] *See* MFA Comment Letter.

[25] *See* BlackRock Comment Letter, MFA Comment Letter and AIMA Comment Letter..

[26] *See* Comment Letter from Lincoln International LLC (Dec. 27, 2022) (Lincoln International LLC Comment Letter) and Comment Letter from Houlihan Lokey, Inc. (Dec. 27, 2022) (Houlihan Lokey, Inc. Comment Letter).

[27] *See* ICI Comment Letter and AIMA Comment Letter.

[28] *See* NSCP Comment Letter, BlackRock, Comment Letter and Houlihan Lokey, Inc. Comment Letter.

[29] *See* NSCP Comment Letter, "Moreover, many of our members believe that the proposed rule would mandate formality and documentation that would not meaningfully reduce risk of inadequate performance by a vendor but would materially increase expense and the burden on the compliance function."

[30] Rule 206(4)-6 was published in the Federal Register on February 7, 2003 (*see*, 68 FR 6593), while Rule 206(4)-7 was published in the Federal Register on December 24, 2003 (see, 68 FR 74730).

[31] *See* ICI Comment Letter.

[32] *See* Lincoln International LLC Comment Letter, ICI Comment Letter, and MFA Comment Letter.

[33] *See* Lincoln International LLC Comment Letter, Kroll Comment Letter and Houlihan Lokey, Inc. Comment Letter.

[34] 87 FR 68816 at 68869.

[35] Advisers faced a number of issues and disruptions implementing the Marketing Rule because of the need to coordinate with service providers, including those who are not subject to the SEC's jurisdiction. Those issues included ensuring third party manager fact sheets present performance information net of fees and performance reports generated from third party investment analysis software include adequate disclosures, particularly those required for the presentation of hypothetical performance information.

[36] *See* BlackRock Comment Letter, MFA Comment Letter, AIMA Comment Letter and ICI Comment Letter.

37 *See* Lincoln International LLC Comment Letter and AIMA Comment Letter.

38 *See* 87 FR 68816 at 68819 (discussing that 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; an adviser remains liable for its obligations, including under the Advisers Act, the other Federal securities laws and any contract entered into with the client, even if the adviser outsources functions.)

39 Proposed Rule 211(h)(2)-1(a)(5) (87 FR 16886) (prohibiting an investment adviser to a private fund from, directly or indirectly, seeking reimbursement, indemnification, exculpation, or limitation of its liability by the private fund or its investors for a breach of fiduciary duty, willful misfeasance, bad faith, negligence, or recklessness in providing services to the private fund).

40 *See* AIMA Comment Letter.