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

Submitted via email (rule-comments@sec.gov)

Re: Proposed Rules and Rule Amendments Regarding Outsourcing by Investment Advisers [Release No. IA-6176; File No. S7-25-22]

Dear Ms. Countryman:

This letter is submitted by Akin Gump Strauss Hauer & Feld LLP, an international law firm with a significant investment management practice that, among other things, represents registered investment advisers, exempt reporting advisers and other entities that advise and manage private funds.

This comment letter provides certain comments and views regarding the impact that proposed Rule 206(4)-11 and proposed amendments to Rule 204-2 and Form ADV (collectively, the "Proposed Amendments"), which were proposed by the U.S. Securities and Exchange Commission (the "Commission") in Investment Advisers Act Release No. IA-6176[1] (the "Proposing Release"), would have on investment advisers and their clients. For the sake of clarity, we point out that this comment letter represents the views of members of the firm who advise private funds and is not intended to reflect the views of any particular firm client or group of clients.

We appreciate the Commission providing us the ability to comments on the Proposed Amendments and recognize the time and effort invested by the Commission and the Staff of the Division of Investment Management (the "Staff") in formulating the Proposed Amendments and in drafting the Proposing Release.

BACKGROUND

The Proposing Release prohibits a registered investment adviser from retaining a "Service Provider" to perform a "Covered Function" unless:

- That investment adviser performs due diligence with the scope and depth prescribed by the Proposed Amendments; and

[1] Outsourcing by Investment Advisers, SEC Release No. IA-6176 (October 26, 2022), *available at* https://www.sec.gov/rules/proposed/2022/ia-6176.pdf.

- That investment adviser engages in ongoing monitoring of the Service Provider and its performance.

COMMENTS, CONCERNS and SUGGESTIONS

We agree with the Commission that advisers are engaging third-party experts both in greater numbers and in a greater number of areas than ever before. The reasons for this trend vary—a decision is driven sometimes by economics (*e.g.*, where a consultant could provide services on par with what the investment adviser would provide but on a more cost-effective basis) and sometimes by the desire to access expertise that is beyond the scope of what a particular adviser can provide (*e.g*., higher-level risk measurement and management services or compliance consulting services).

Taken as a whole, we believe that most industry participants—both managers and investors—would state that the growth in specialized service providers has enabled investment advisers of all sizes and strategies, and particularly smaller or younger advisers, to deliver more and better advisory services to clients and private fund investors. The Proposing Release makes it clear that the Commission and the Staff both understand the actual and potential benefits of engaging third-party experts to supplement an investment adviser's capabilities.[2]

What Is the Rationale for the Proposed Amendments?

After carefully reviewing the Proposing Release, we are not sure why the Commission determined that this rulemaking is needed. A reader could easily come to the conclusion that there are unreported but widespread failures by investment advisers that, without any disclosure or consent, are engaging in wholesale, "back-door" outsourcing of critical investment functions to unqualified third parties, failing to monitor those third parties and somehow escaping any liability for the resulting damage.

We do not believe that the matters cited in the Proposing Release provide evidence such concern is an actual material risk to clients in today's advisory industry. In support of the Proposed Amendments, the Proposing Release cites examples such as the following:

- One of the world's largest custodians did not accurately calculate the net asset values for various mutual and exchange-traded funds.
- An oversight failure at a fund administrator resulted in the exposure of certain investor data.
- An adviser filed inaccurate information in Forms ADV prepared by an outsourced Chief Compliance Officer based on information provided by the adviser's personnel.

[2] The Proposing Release states, *e.g.*, "Service providers may give the adviser or the adviser's clients access to certain specializations or areas of expertise, reduce risks of keeping a function in-house that the adviser is not equipped to perform, or otherwise offer efficiencies that are unavailable to or unachievable by an adviser alone. Use of service providers can provide staffing flexibility by reducing the burdens on advisers' existing personnel and may mitigate the need to hire new personnel (which generally entails hiring and onboarding costs in addition to salaries and benefits)." Proposing Release at p. 7.

- Investment advisers employed models and volatility guidelines received from a third party without confirming that those models worked as intended.

Our experience indicates that investment advisers generally are quite thoughtful about hiring third-party experts and that they do, in fact, provide appropriate levels of supervision. We have, of course, considered each of the situations cited in the Proposing Release and (i) we believe that the situations cited are outliers and not representative of the vast majority of third-party expert engagements by investment advisers and (ii) we do not believe that the Proposed Amendments would have changed any of the outcomes in that small number of situations, given that the third parties involved were well regarded and, in most cases, the alleged errors or omissions resulted from actions within the very scope of the expertise sought.

We hope that this and similar comment letters will encourage the Commission and Staff to reconsider whether the Proposed Amendments are necessary, whether they are premature or unnecessary, or whether the adoption of the Proposed Amendments would be the use of a blunt object when a more finely pointed instrument would be a better choice.

The Definition of Covered Function Is Too Simplistic and Too Broad.

The Proposed Amendments define "Covered Function" as:

> a function or service that is necessary for the investment adviser to provide its investment 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. A covered function does not include clerical, ministerial, utility, or general office functions or services.

This language could be read very broadly—perhaps, we worry, so broadly as to encompass any service that is provided by a third party to an investment adviser. In this concern, we are in good company, as Commissioner Uyeda stated that "almost any function outsourced by an investment adviser could trigger the numerous oversight functions set forth in the Proposed Amendments." We would urge the Commission to reconsider the potential scope of this core definition and, at a minimum, defer any rulemaking and to seek additional comments on this specific point.

The Covered Function concept is also concerning because it appears to be based on a much simpler concept than exists in actual practice. The Proposing Release repeatedly uses the term "outsourcing" for the engaging of third-party experts and presupposes a one-for-one correlation between individual advisory functions and specific contracted services. In other words, the implication is that each task provided by a third party directly corresponds to a covered function and is thus easily scoped, diligenced and monitored. The reality, however, is that a service provided by a third-party expert often applies to multiple functions. A compliance consultant, for example, may provide advice that is also used for brokerage, trading and risk-management decisions. Valuation advice, similarly, can play in a role in risk management, investment, compliance and other functions.

This (admittedly nuanced) observation is not one that the Commission expressly requested comments on. Given the potential "knock-on" effect of these non-obvious functional overlaps, we would suggest, if the Commission intends to pursue the Proposed Amendments, that comments on this point and its potential unintended consequences be sought from the industry as a whole prior to any final rule being adopted.

The Proposed Amendments Will Discourage Beneficial Engagements of Third-Party Experts.

The reality in today's market is that investment advisers of all sizes are encouraged or required by clients and investors, as well as by regulators, to have world-class systems and expertise in place. As a result, engaging third parties to provide expertise and services has become a necessity. Engaging third-party experts brings specialized expertise to a manager and reduces the temptation (or the necessity) to choose areas in which to cut corners. Engaging third parties also brings a new perspective to an investment adviser's processes and policies. For example, engaging third-party valuation or risk experts mitigates the risk of an adviser making both inadvertent and conflicted decisions that are ultimately incorrect. (The Proposing Release makes it clear that both the Commission and the Staff understand this.)

We know from our own discussions with investment advisers that many of them are concerned that every error or omission by a third party could be shoehorned into a diligence or supervision failure by the investment adviser and its personnel. This "gotcha" fear underlies our belief that the Proposed Amendments underestimate the extent to which investment advisers would have to choose between providing the best service for their clients by engaging third-party experts and assuming the potential liability under the Proposed Amendments if anything done by those third parties goes wrong.

As a result, we worry that managers may avoid assuming outsourcing diligence and supervision risk by keeping in-house functions that would have been performed better by being outsourced, thereby depriving their clients of the best services possible, and that this will happen much more often than the Commission appreciates. A review of the entire "Effects on Efficiency, Competition, and Capital Formation" section of the Proposing Release, for example, could cause a reader to conclude that there is a paucity of actual economic or financial data and models, possibly leading to concerns on the rigor of the core analysis. We would therefore strongly urge the Commission to abandon this rulemaking effort for the time being and to seek more information on how the industry will actually respond to effectiveness of the Proposed Amendments. This could take the form of inquiries from the Division of Examinations, some kind of a pilot program, a study from a respected economist or organizational behavior scholar or simply a reopening of the comment period.

The Commission's Goals Are Already Addressed by Common Law Agency Principles.

We suspect that all industry participants support the Commission's goal of ensuring that decisions to engage third-party experts are made in a responsible matter. We believe, however, that this goal is adequately addressed by the current legal structures employed in this industry.

Investment advisers are currently subject to an extensive regime of legal and regulatory duties, including fiduciary duties imposed by the Investment Advisers Act. This regime already requires investment advisers to act in a manner consistent with their duties and to ensure they implement and maintain policies and procedures reasonably designed to ensure compliance with the Investment Advisers Act. Likewise, the anti-fraud provisions of Section 10(b) and Rule 10b-5 restrict fund managers and other investment advisers from using any device, scheme or other artifice to defraud purchasers in connection with the sale of a security, thereby ensuring that investors in funds or products offered by investment advisers are protected.

A decision to contract with a third-party expert to supplement or perform advisory or related functions has no effect on these fiduciary and other duties. Under the interplay of most investment management agreements and state law (including the law of agency), investment advisers are already liable for failures to perform their agreed-upon responsibilities. This liability attaches irrespective of whether that failure results from an act or omission of the investment adviser itself, or from an act or omission of a third-party expert that the investment adviser was entitled to enlist to assist it in fulfilling its duties. In fact, as the Staff even pointed out in the Proposing Release, “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. . . .”

Accordingly, the increased requirements of the Proposed Amendments are, at best, unnecessary and redundant. Instead of imposing a new regime of regulations around outsourcing on the fund manager community, we believe a more effective approach would be for the Staff to follow the methodology it has employed numerous times to deter harmful behavior. Specifically, the Division of Enforcement or the Division of Examinations could issue a risk alert that puts all investment advisers on notice of their existing fiduciary duties and how those duties apply to the use of third-party experts and other service providers. If, following the publication of that guidance, those Divisions witness examples of mal- or nonfeasance resulting from the engagement of third-party experts, additional actions, such as the Proposed Amendments, should then be considered.

We also are concerned that “proposal fatigue” has reduced the amount of consideration paid to the Proposing Release. We would suggest that the Commission request that the Staff analyze the quantity and detail of the comments received on this proposal to other proposed rulemakings under the Investment Advisers Act over the past two years. If there is any concern that there has been a statistically significant drop in comments, we would ask the Commission to consider recirculating the Proposing Release for additional comments (with whatever changes are made pursuant to this current round of comments).

CONCLUSION

We would close by again thanking the Commission and the Staff for their strenuous and serious efforts to protect clients and the investing public, and for doing so in a transparent and responsible manner. We would hope and expect that, after reflecting on the points raised in this comment letter, the Commission will conclude that the Proposed Amendments are not necessary and could, in fact, be counterproductive. If the Commission determines to pursue the Proposed Amendments, we would urge the Commission to seek additional comments on the points raised in this and in other comment letters.

We would be pleased to respond to any inquiries you may have regarding our letter or our views on the Proposed Amendments more generally. Please feel free to direct any inquiries to Brian Daly at +1 212.872.8170 or at bdaly@akingump.com.

Very truly yours,

/s/ Brian T. Daly

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