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22 December 2022

Vanessa Countryman

Secretary, Securities and Exchange Commission

100 F Street, NE

Washington

DC 20549

BY EMAIL: rule-comments@sec.gov

Dear Ms. Countryman,

S&P Global Market Intelligence: Pricing, Valuations & Reference Data – SEC Request for Comment on Outsourcing by Investment Advisers

File Number S7-25-22

1. SUMMARY RESPONSE ON PROPOSALS FOR OUTSOURCING BY INVESTMENT ADVISERS

1.1 This response is provided to the SEC by S&P Global Market Intelligence ("**SPGMI**") as a provider of pricing, data and valuation services only.

1.2 The IOSCO Principles on Outsourcing dated October 2021 (the "**IOSCO Principles on Outsourcing**"), set out a global framework for the oversight and management by certain regulated entities of their outsourced activities. While the IOSCO Principles on Outsourcing are not directly applicable to investment advisers, they are nonetheless widely used by market participants globally to inform their outsourcing frameworks.

1.3 The IOSCO Principles on Outsourcing are also used by local national regulators globally as a basis for shaping and implementing local law in relation to the supervision of outsourcing, which assists in ensuring that national outsourcing rules are based on the same definitions and basic principles.

1.4 The IOSCO Principles on Outsourcing define outsourcing as "a business practice in which a regulated entity uses a service provider to perform tasks, functions, processes, services or activities (collectively, "tasks") that would otherwise be undertaken by the regulated entity itself." In our view, it is important that any new outsourcing rules reflect this definition and the IOSCO Principles on Outsourcing more broadly. Should the SEC proceed with the definition of 'covered function' as currently proposed, this would represent a significant departure from what is internationally recognised as an 'outsourcing'. This would in turn mean that the scope of what is considered to be an outsourcing for SEC registered investment advisers is much wider than that both (i) for their peer firms in other jurisdictions and (ii) for regulated entities operating within other regulated fields in the US (for example trading venues, market intermediaries, market participants acting on a proprietary basis, and credit rating agencies all of which are specifically in scope of the IOSCO Principles on Outsourcing). There is no reason, in our view, for such a divergent approach to be taken and should the SEC proceed with a new outsourcing regime for investment advisers the definition of 'outsourcing' should be aligned with the IOSCO definition in order (i) to avoid regulatory arbitrage (ii) to ensure that investment advisers are not subject to a wider regime than other regulated entities, and (iii) to ensure that there is international consensus on the approach to regulating and supervising key areas of risk for regulated firms.

1.5 Further, the outsourcing regime proposed by the SEC (the "**Proposed Rule**") is extensive, covering a wide range of obligations and potential service providers. This should be contrasted

with the substantive diligence and oversight provisions required under the U.S. Investment Company Act of 1940 (the "**1940 Act**"), which, while centering on similar policy considerations as those articulated by the SEC in the Proposed Rule, only extend to a limited category of service providers (i.e., custodians, underwriters, administrators and transfer agents). It would mark a material change in practice if the Advisers Act, specifically with reference to the Proposed Rule, were to mandate a more fulsome outsourcing regime than the 1940 Act, which is currently the most comprehensive regulatory regime in the asset management space in the United States. In our view, the stated policy aims of the SEC would be achieved by a regime which was limited to a number of key service providers, as is the approach under the 1940 Act.

1.6 As a result of the rules promulgated both under the Advisers Act and the 1940 Act and the SEC's historic and continued focus on compliance oversight, industry participants, including investment advisers, have already implemented robust practices relating to the diligence, monitoring, and record-keeping of service providers. In addition, an investment adviser must provide sufficient oversight of service providers so as to fulfil its fiduciary duty. Rule 206(4)-7 of the Advisers Act requires an adviser to adopt and implement reasonably designed written policies and procedure with the goal to prevent, detect, and promptly correct violations and to conduct annual reviews of the adequacy of such policies and procedures. Furthermore, in the Rule 206(4)-7 adopting release, by reference to "detection," the SEC noted that an effective compliance program will have a component that tests and analyzes information and trends on a regular basis, and separately set forth a non-exhaustive list of critical areas relevant to compliance programs of investment advisers, including valuation and business continuity. In response to the SEC's focus on arm's length negotiations with affiliated entities to mitigate any actual or apparent conflicts of interest, most fund managers have developed robust policies and procedures with respect to selecting, diligencing, monitoring and overseeing service providers. As such, the Proposed Rule does not appear to further the aims of investor protection or mitigation of systemic risk given existing substantive regulation and industry practices in this space.

2. RESPONSE TO SPECIFIC SEC QUESTIONS

Note that (i) the SEC questions are shown below in italics and the numbered questions reflect the SEC's numbering, and (ii) for clarity we have not provided a specific response to every question given our summary position above.

1. Is the proposed scope of the rule appropriate? Why or why not? In what ways, if any, could the proposed scope of the rule or the proposed definition of covered function better match our policy goals? Does it need to be made clearer?

Response:

The first part of the definition of a 'covered function' that it is "a function or service that is necessary for the adviser to provide its investment advisory services in compliance with the Federal securities laws" fails to include a reference to the fact that it should be a service that the adviser would otherwise carry out itself. Without the addition of this requirement there is a significant risk that many services which are not currently considered by either the adviser or the service provider to be an outsourcing will be caught by the proposed rules.

This addition to the definition is in line with the IOSCO Principles on Outsourcing, which define outsourcing as "*a business practice in which a regulated entity uses a service provider to perform tasks, functions, processes, services or activities (collectively, "tasks") that would otherwise be undertaken by the regulated entity itself*." Should the SEC proceed with the definition of 'covered function' as currently proposed, this would represent a significant departure from what is internationally recognised as an outsourcing, and an increase of the scope of outsourcing for SEC registered investment advisers over and above their peer firms in other jurisdictions and operating within other regulated fields in the US.

Further, the substantive diligence and oversight provisions required under the 1940 Act, which centers on similar policy considerations as those articulated by the SEC in the proposed rule (the

"Proposed Rule"), extend only to a limited category of service providers (i.e., custodians, underwriters, administrators, transfer agents). It would mark a material change in practice if the Advisers Act, specifically with reference to the Proposed Rule, were to mandate more fulsome oversight obligations than the 1940 Act, currently the most comprehensive regulatory regime in the asset management space in the United States.

In our view, it is important that the IOSCO Principles on Outsourcing are followed by national regulators when introducing national rules on outsourcing, in order to avoid regulatory arbitrage and to ensure that there is international consensus on the approach to regulating and supervising key areas of risk for regulated firms.

3. In addition to the proposed oversight requirements when an adviser outsources a covered function, should the rule include an express provision that prohibits an adviser from disclaiming liability when it is not performing a covered function itself?

Response:

We agree that where an adviser outsources a function which it would otherwise perform itself, an adviser should not be able to disclaim liability for the performance of that service. However, this is a further reason why it is important to limit the extent of what is considered to be an outsourcing to functions which would otherwise be performed by the adviser itself. An adviser should not be required to accept liability for services which are not considered to be an outsourcing under the IOSCO Principles on Outsourcing. Doing so would significantly increase an investment adviser's potential liability for the activities of third parties whose services are not under their control, and would put the adviser at a competitive disadvantage when compared to peer firms in other jurisdictions (for example the UK and Europe) where the IOSCO Principles on Outsourcing are followed in national legislation.

4. Is the proposed definition of "covered function" clear? Why or why not? In what ways, if any, could the proposed definition be made clearer?

Response:

Please see responses to Question 1 and Question 3, above.

5. The proposed rule is designed to apply in the context of outsourcing core advisory functions. The proposed rule does so by qualitatively describing what we believe is a core advisory function—namely, a function or service that is necessary for the investment adviser to provide its investment advisory services in compliance with the Federal securities laws. Does the proposed definition of covered function capture this intended core advisory function scope? Should the rule explicitly state that its application is limited to core investment advisory services? If yes, how would we identify and define what would be considered "core investment advisory services"?

Response:

No, we do not think that the proposed definition as currently written is clear that it is limited to core advisory functions and believe that the definition should explicitly state that its application is limited to core investment advisory services. While the Proposed Rule *suggests* that certain functions or services that are related to an adviser's investment decision-making process and portfolio management activities can meet the first prong of the definition of covered function, the staff should incorporate these functions into the definition of "core advisory functions" to limit the scope of the Proposed Rule.

As the SEC suggested, such functions and services can be related to providing investment guidelines (including maintaining restricted lists), creating and providing models related to investment advice, creating or providing custom indices, providing investment risk software 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 client (sub-advisory services). However, such functions and services should be considered "core" only if they are *necessary* for the adviser's investment decision-making process, as opposed to

a function or service the adviser utilizes to further enhance its investment decision-making process. For example, if the authority for valuation is vested with the Board (or equivalent), then any valuation assistance an adviser uses may be deemed to be "outsourced" (as proposed by the SEC). However, if an adviser uses certain valuation services to further confirm or support its investment-decision making process, then such function or service should not be considered a "core investment advisory service."

As such, we believe the staff should strongly consider exempting from the definition of core advisory services those functions or services that an adviser uses as a means to further confirm or support its fundamental investment decision-making process.

6. Instead of our proposed definition, should we define "covered functions" as a specified list of core investment advisory activities, such as "services that are central to the selection, trading, valuation, management, monitoring, indexing, and modeling of investments"? Are there other specific functions or services that should be included or excluded from this list? Please explain. Are the services in this list clear? For example, would we need to define trading in this alternative definition to include allocation and communications related to trades? Would it be clear that subadvisers and portfolio management would be included as "management" in this alternative definition or that risk management is part of management and monitoring? Would it be confusing to list management and selection as well as indexing and modeling in this alternative definition? Is there overlap among the categories? If there is overlap, should the rule list only certain of these categories, such as selection and management, or would certain core services or functions be inadvertently excluded?

Response:

We do not think that a prescriptive list of functions would be appropriate, but rather advisers should be left to determine which of the core advisory services amount to an outsourcing, within the definition we propose under our response to Question 1, above. Instead, we believe a principles-based approach that would enable an investment adviser to tailor their compliance with the Proposed Rule based on their particular circumstance would be appropriate. Providing a specified list of activities would be too slow to respond to the changing regulatory landscape, the introduction of new technologies and changes to the way investment advisers may operate in the future.

7. Should the Commission include or exclude in the definition of covered function any particular functions or services discussed within the release? Should services related to investment risk identification or monitoring be specifically identified, or would they be assumed to be included as part of the selection or management of investments? Instead should the specified list of covered functions/services be the same as those provided by service provider types listed in the proposed amendments to Form ADV?

Response:

The definition of covered function should exclude functions or services the adviser otherwise would not carry out itself. For example, an adviser would not typically carry out activities relating to data collection, pricing, valuation or index creation. We recognize that there are certain instances when the use of such services is vested with the adviser, Board, or equivalent, and in such limited circumstances, we acknowledge that these services may appropriately be included as covered functions.

8. Are there particular types of service providers to which the rule should apply? For example, should the rule explicitly include the service providers advisers would be required to identify in proposed amendments to Form ADV (portfolio management, trade communication and allocation, pricing services, valuation services, investment risk services, portfolio accounting services, client servicing, subadvisory services, and/or regulatory compliance)? Should we explicitly require the rule to apply to index providers, model providers, valuation agents, or other service providers that may be central to an adviser's investment decision-making process?

Response:

In accordance with our response to Question 6, we do not think that a prescriptive list of service providers would be helpful; rather, it should be left to each investment adviser to determine which of the service providers utilized amount to an outsourcing, within the scope of the definition (as we propose it is amended).

9. What would be the advantages and disadvantages of explicitly identifying the types of functions or providers that would trigger the rule? For instance, is there a risk of being over-inclusive and under-inclusive if we take such an approach? Are there certain services or functions that should be considered "core" for all advisers, or does what constitutes a "core" advisory function vary from one adviser to the next? Should what is considered "core" correlate to a certain percentage of clients who receive (and presumably can therefore be affected by) the service provider's services? That is, would a service provider's functions be considered "core" to an adviser if they could have an impact on a certain minimum percentage of the adviser's clients? Should it correlate to a certain percentage of regulatory assets under management that receive (and, again, presumably can be affected by) the service provider's services? That is, would a service provider's functions be considered "core" to an adviser if they could have an impact on a certain minimum percentage of the adviser's regulatory assets under management? What would be a percentage of either such measurement that should trigger application of the rule? 5%? 10%? 15%? 20%? Please explain your answer.

Response:

Please see our responses to Question 6 and Question 7. In addition, imposing a quantitative percentage threshold as discussed in this question would involve an unnecessary additional burden to investment advisers, when a flexible definition as suggested in our response to Question 1 would achieve the same aim of investor protection.

10. Should data providers be explicitly included within the scope of the rule? Are there specific types of data providers that might be considered "covered functions," such as providers of security master data, corporate action data, or index data?

Response:

Including data providers explicitly within the scope of the rule would not accurately reflect the services that data providers provide to investment advisers. It is not typically the case that an investment adviser would or could provide data itself, without seeking the services of a data provider; in those circumstances the services would not fall within the definition of outsourcing under the IOSCO Principles on Outsourcing. A further important aspect in relation to the role of a data provider is their independence. Data providers have no linkage to the clients they provide their services to and are not under the control or direction of their clients. This construct is at risk of being undermined if a data provider is considered to be an outsourced service provider, where an investment adviser would be required to exercise a degree of oversight and control over the services provided.

Including data providers as outsource service providers would represent a significant shift in the arm's length relationship that currently exists between investment advisers and data providers, where both investment advisers and data providers consider the services to be provided to the investment adviser as fulfilling a function which the investment adviser would otherwise perform itself. Any change to this construct would mark a significant change in the market and may necessitate changes to contracts and fee structures to reflect an outsourcing arrangement (which for the avoidance of doubt we do not agree that the provision of data services would generally be considered), where it is likely that fees for clients would need to increase to reflect the greater degree of interaction the provider would need to have with its clients, in order for the clients to satisfy the outsourcing obligations.

12. Should we revise the proposed exclusion for clerical or ministerial services? Should we provide different or additional specific exclusions from the definition of covered function under the rule? Which ones, if any? For example, should we use the same definition of supervised person as in the Advisers Act? Should we explicitly exclude broad-based and widely published indices or specific clerical or ministerial services such as basic utilities and widely commercially available operating systems, word processing systems, or spreadsheets, utilities, or general office functions or services? Should we exclude functions or categories of services or should we list specific service providers that should be excluded? How should we view these services or functions when they are integral to the provision of a covered function (e.g., when investment performance is calculated in a spreadsheet or an order management system is hosted in the cloud)?

Response:

In accordance with the SEC's proposal as set out in Question 5, we would not expect clerical or ministerial services to be within the scope of a 'core advisory function' and do not take the view that an exclusion is specifically required.

Following on from our response to Question 10 in relation to data providers, the services offered by data providers are widely commercially available, and are offered on a non-discriminatory basis to market participants. It is difficult to see how the normal course of the provision of these services to investment advisers can be considered to be an outsourcing.

We believe that the SEC should incorporate of the definition of "supervised person" in Section 202(a)(25) of the U.S. Investment Advisers Act of 1940 (the "Advisers Act).

13. Should we define "covered function" more broadly or more narrowly, and if so, how? For example, should we only use the first prong of the proposed definition and broaden the definition to any function or service that is necessary for the investment adviser to provide its advisory services in compliance with the Federal securities laws, regardless of the likely impact on clients of non- or negligent performance? Or should we only use the second prong of the definition to apply the rule to any services or functions that, if not performed or performed negligently, could potentially have a material negative impact, regardless of whether they are necessary for the adviser to provide its advisory services in compliance with the Federal securities laws? Should we change the second prong of the definition, for example, by applying the rule to any services or functions that if not performed or performed in a manner materially different from the adviser's representations or undertakings could potentially have a material negative impact?

Response:

In our view, the first prong of the definition alone, with the introduction of the requirement that it must be a service that the investment adviser would otherwise perform itself, would be sufficient to achieve the investor protection aims which the SEC seeks to address.

The proposed second prong of the definition introduces subjectivity, which may lead to widely differing interpretations across the market. Further, there may be circumstances where it is not possible to assess the impact of non-performance or negligent performance. The SEC's stated aims can still be achieved by limiting the definition to the proposed first prong, as we suggest is amended.

16. Is the proposed definition of "service provider" clear? Why or why not? In what ways, if any, could the proposed definition be made clearer?

Response:

The proposed definition of service provider is clear and we agree that this should encompass affiliates of the investment adviser.

18. Should the rule define what it means to retain a service provider to perform a covered function? If so, how? Should we explicitly state that outsourcing would include affiliated entities of an adviser, including parent organizations?

Response:

In our view, there is a good level of understanding among investment advisers as to what it means to retain a service provider, and further definitions beyond the proposed definition of outsourcing (in accordance with our response to Question 1, above), will add an additional layer of complexity which is unnecessary.

19. Should we define when an adviser would retain a service provider for purposes of the whether a service provider arrangement should be subject to the rule? For example, should the rule apply where the adviser recommends the service provider to some or all of its clients? Would a relevant factor be the extent to which the adviser makes arrangements for the client to engage the service provider? Should the approach differ depending on whether the client is a fund (registered or not) or a separately managed account and the extent to which the adviser is a control person of the fund or has some control over the fund's contracting arrangements? Or should the proposed rule only include service providers that contract directly with the adviser? If so, why? Should we provide an explicit exclusion for all advisers that engage service providers to perform covered functions as part of a larger program or arrangement, such as the sponsor of a wrap fee program or other separately managed account program in which the sponsor is subject to the proposed rule with respect to the participation of the service providers in the program?

Response:

In our view none of the examples provided in this question amount to an outsourcing by the investment adviser; where a client of an investment adviser directly engages a third party suggested by their investment adviser, this cannot, and should not, amount to an outsourcing, as the third party is providing services directly to the client, rather than via the investment adviser.

The investment adviser may have other obligations in this scenario, for example, where it acts as a fiduciary, however, this is not the same construct as an investment adviser outsourcing some or all of the functions it would otherwise perform itself.

32. Should we require advisers to obtain third-party experts, audits, and/or other assistance to oversee a service provider when the adviser is outsourcing a function that is highly technical, or the oversight requires expertise or data the adviser lacks? For example, if an adviser is outsourcing to a service provider that provides valuation or pricing of complex or private securities, or a service provider that incorporates artificial intelligence into its services, should that adviser be required to confirm it has sufficient internal expertise to effectively oversee the service provider, and if not, obtain a third-party expert to provide such oversight?

Response:

We do not think this is necessary in order to achieve the SEC's stated aims. It would place a significant additional burden on advisors in terms of both cost and engagement, without providing additional assurance in terms of the effective provision of the services by the outsourced service provider.

36. The proposed rule requires that the due diligence be conducted before the service provider is engaged. Are there reasons that due diligence cannot be completed prior to engaging a service provider? If so, please explain and provide examples. For example, should there be an exception for emergencies? How would we define emergency? Should an exception for emergencies be time-limited (e.g., one month) or permitted for the duration of the emergency?

Response:

Yes, we believe that there should be exceptions to this requirement. For example, an existing outsource service provider may cease trading on short notice and the investment adviser must

be able to quickly engage an alternative in order to ensure there are no disruptions to its own service provision. An additional example is where an investment must be made before diligence can be conducted or concluded in order to act in the best interests of investors or where there are no providers with capacity to provide a service at a given time. In these circumstances, exemptions should be made to ensure that investors are not disadvantaged.

We do not believe that a time period is appropriate given the different issues that may impact the ability of the investment adviser to find an alternative outsource service provider. We suggest that instead the investment adviser should use all reasonable endeavours to find an alternative provider as soon as is reasonably practicable.

In terms of the due diligence to be carried out and the documents to be provided by service providers, this in our view, should be a standard set of documents which do not require the service provider to expend a significant period of time and money compiling, otherwise this will result in increased costs to the investment advisers for the services, which in turn will impact investors.

37. Are there other core factors that advisers should be required to consider in conducting due diligence? If so, what are those factors? For example, should advisers be required to confirm the financial stability of a service provider through the review of audited financials, or should certain service providers be required to provide certain third-party certifications or reports such as a Systems and Organizational Controls report ("SOC 1") or other internal control report? Should service providers be required to have third-party financial support, such as fidelity bonds, errors and omissions insurance, or other support? If so, what type and level of support should be required?

Response:

In our view the factors suggested are sensible. However, the SEC should be mindful of the ability of outsource service providers to meet certain of these requirements, for example to provide a fidelity bond, and not impose requirements which would push certain providers out of the market.

51. Should we prescribe the frequency of monitoring instead of requiring an adviser to monitor its service providers with a manner and frequency such that the adviser reasonably determines that it is appropriate to continue to outsource the covered function and to outsource to the service provider, as proposed? Or should we prescribe a minimum frequency of monitoring? For example should we require that monitoring of service providers be conducted monthly? Quarterly? No less than annually? Why or why not?

Response:

Given the different types of services that can be outsourced, there is no one size fits all approach. Investment advisers should put in place such monitoring as is reasonable given the service being outsourced and should periodically review whether the frequency they have implemented remains appropriate.

56. Are the proposed requirements to disclose service providers that perform a covered function as defined in rule 206(4)-11 appropriate? Should we instead require all registered advisers that outsource any services to provide the specified information and then mark each service to indicate whether it is a covered function within rule 206(4)-11 or not? Or should we include a broader Form ADV reporting requirement, such as requiring all advisers (e.g., exempt reporting advisers and advisers registering with state securities authorities) to provide the specified information regarding any outsourced service or function or only those that are subject to rule 206(4)-11 or any substantially similar regulation?

Response:

We do not believe that these proposals are appropriate. Investment advisers maintain lists of their service providers which the SEC can request. No investor protection objective is served by making these lists public. Further, there may be good reasons why investment advisers do not

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wish to make these details public, for example, for reasons of confidentiality and commercial sensitivity.

In our view Form ADV does not require any change and the service providers which it covers are not outsource service providers in any event (for example auditors and custody providers). Including outsource service providers in the Form ADV does not add anything in terms of investor protection and transparency.

59. Do advisers have concerns with the public disclosure of service providers that perform covered functions? If so, what are those concerns? For example, are there categories of service providers that should not be disclosed publicly due to competitive, trade secret, compliance, or other risks? Should we require such disclosure to be reported non-publicly to the Commission in a format other than the Form ADV? If so, how?

Response:

Please see our response to Question 56, above. Investment Advisers already maintain lists of their outsource service providers which the SEC already has the authority to request.

Yours sincerely,

Christopher McLoughlin

General Counsel, S&P Global Market Intelligence