

December 27, 2022

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

VIA E-MAIL TO RULE-COMMENTS@SEC.GOV

**Re: Comment Letter of Federated Hermes, Inc. on the Securities and Exchange Commission's Request for Comment on Outsourcing by Investment Advisers (File No. S7-25-22)**

Dear Ms. Countryman:

Federated Hermes, Inc. and its subsidiaries ("**Federated Hermes**")<sup>1</sup> submit this comment letter to the U.S. Securities and Exchange Commission (the "**Commission**") regarding the Commission's request for comments on the Commission's proposed rules on prohibiting registered investment advisers ("**advisers**") from outsourcing certain services and functions to a service provider without meeting minimum due diligence, monitoring and recordkeeping obligations.<sup>2</sup>

In sum, the Proposing Release proposes:

- New proposed Rule 206(4)-11 under the Investment Advisers Act of 1940 (the "**Advisers Act**"), which requires advisers to, among other things, perform due diligence on service providers prior to engaging such providers to perform a "covered function" and periodically monitor the performance of the service provider and reassess the selection of the provider to perform the "covered function";
- Amendments to Rule 204-2 under the Advisers Act whereby requiring advisers to maintain books and records documenting an adviser's due diligence and monitoring compliance under proposed Rule 206(4)-11; and
- Revising Form ADV to require advisers to provide certain census-type information about covered service providers on Form ADV.

Federated Hermes fully supports the comment letters submitted by the Investment Company Institute (the "**ICI**") and the Securities Industry and Financial Markets Association ("**SIFMA**") regarding the Proposing Release (respectively, the "**ICI Letter**" and "**SIFMA Letter**"). In particular, Federated Hermes strongly agrees with the ICI that the Commission failed to provide any evidence that proposed rules are required. Moreover, Federated Hermes similarly agrees with the ICI and SIFMA that an adviser's existing fiduciary duties and obligations sufficiently govern their use of service providers. In the Proposing Release, the Commission admits:

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<sup>1</sup> Federated Hermes, Inc. (NYSE: FHI) is a global leader in active, responsible investment management, with \$624.4 billion in assets under management as of September 30, 2022. We deliver investment solutions that help investors target a broad range of outcomes and provide equity, fixed-income, alternative/private markets, multi-asset and liquidity management strategies to more than 11,000 institutions and intermediaries worldwide. Our clients include corporations, government entities, insurance companies, foundations and endowments, banks and broker-dealers.

<sup>2</sup> Release Nos. IA-6176; Release Nos. IA-6176 (October 26, 2022) at <https://www.sec.gov/rules/proposed/2022/ia-6176.pdf> (the "**Proposing Release**").

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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. In addition, an adviser cannot waive its fiduciary duty. Accordingly, an adviser should be overseeing outsourced functions to ensure the adviser's legal obligations are continuing to be met despite the adviser not performing those functions itself.<sup>3</sup>

Accordingly, Federated Hermes questions the merits of proposed rules and amendments within the Proposing Release as the Commission has not adequately identified any harm caused by an advisor failing to uphold its fiduciary obligations whereby requiring a remedy like the overly burdensome and prescriptive proposed Rule 206(4)-11.

Further, we hold similar concerns raised by the ICI and SIFMA that the definition of "covered function" is overly broad. The Proposing Release defines a "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.<sup>4</sup>

The proposed definition is broad enough that it could be interpreted to encompass all functions that may be outsourced, except those "clerical, ministerial, utility, or general office functions or services."<sup>5</sup> Broad definitions, such as this one, are subjective, and the Commission admits this concern in the Proposing Release, "[...] *certain of these functions may be covered functions for one adviser but not for another adviser, depending on the facts and circumstances.*"<sup>6</sup>

Subjective definitions create confusion, concern and are not easy to administer and comply with. The Commission must clearly and objectively define the meaning of a "covered function." Like SIFMA, we believe "covered functions" should be limited to only those functions that are "critical" (and directly related) to an adviser's provision of advisory services (e.g., recordkeeping services). Further, we also agree that functions that are required to be outsourced should be excluded from the "covered function" definition.

Even with a more narrowly focused scope, an adviser may not be able to comply with these new proposed rules. Certain service providers purposefully limit operational transparency and are not willing to permit any organization to conduct due diligence, which could cause unjustified enforcement actions against advisers. The proposed rule attempt to legislate contractual relationships with service providers that, in many cases, are outside of the regulatory remit of the Commission. The same service providers (and many others) also may take issue with the new proposed Form ADV disclosure as that unnecessarily subjects them as targets for cyberattacks from bad actors. The comment letters submitted by the ICI and SIFMA highlight this issue and our concerns.

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<sup>3</sup> Proposing Release at 13.

<sup>4</sup> See Proposed rule 206(4)-11(b).

<sup>5</sup> The Proposing Release expressly excludes "clerical, ministerial, utility, or general office functions or services" from its proposed "covered function" definition. See Proposed rule 206(4)-11(b).

<sup>6</sup> Proposing Release at 23.

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The potential harm and consequences created by these proposed rules and amendments outweigh the little to no improvement on the overall protection to investors. Accordingly, because the Commission failed to provide any reasonable justification as to why the Proposing Release is required, and for all reasons stated in this letter and in the comment letters submitted by the ICI and SIFMA, Federated Hermes strongly opposes the Proposing Release and the proposed rules and amendments therein.

Federated Hermes appreciates the opportunity to comment on the Proposing Release. Please let us know if you have any questions or comments on this submission.

Sincerely,



Peter J. Germain  
Chief Legal Officer

cc: The Honorable Gary Gensler  
The Honorable Hester M. Peirce  
The Honorable Caroline A. Crenshaw  
The Honorable Mark T. Uyeda  
The Honorable Jaime Lizárraga

Division of Investment Management  
William Birdthistle, Director  
Sarah ten Siethoff, Associate Director