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VIA ELECTRONIC FILING

Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Re: Request for Comment on Proposed Rules Regarding Outsourcing by Investment Advisers; Rel. No. IA-6176; File No. S7-25-22

Dear Ms. Countryman:

Ropes & Gray LLP appreciates the opportunity to provide these comments to the Securities and Exchange Commission (the "Commission") on the above-referenced matter. Our firm represents hundreds of asset management firms that are regulated by the Commission, including those that advise private equity, credit, real estate, and hedge funds across a wide range of industries and asset classes, certain of which are also investors in other private funds.

The proposed rules set forth in the Commission's release titled Outsourcing by Investment Advisers, Release No. IA-6176, (Oct. 26, 2022) (the "Proposed Rules") address certain principles and requirements for investment advisers engaging in agreements to outsource certain covered functions to service providers. The Proposed Rules thus would directly apply to our clients. Given this fact, we write to provide our views on aspects of the Proposed Rules as practitioners with decades of experience in providing legal counsel to these clients. The comments and opinions expressed herein are not intended to represent individual clients' views, but rather Ropes & Gray's perspective complemented by general input from our clients.

The use of external service providers is commonplace in the industry and, in our experience, as a result of market pressures and in order to satisfy their existing fiduciary duties under Section 206 of the Investment Advisers Act of 1940, as amended (the "Advisers Act"), advisers typically engage in diligence of these external service providers and negotiate contractual terms of these arrangements, in each case, in a manner that is tailored to the significance of the services being provided. Such contractual terms include, for instance, those with respect to the termination and transition of replacement providers. Therefore, we would respectfully note that the Proposed Rules, on the whole, would cause significant additional compliance and economic costs to address a concern that is currently managed through a combination of market pressure and an adviser's existing legal duties under the Advisers Act. The Commission needs to weigh any corresponding incremental benefits the Proposed Rules would provide very carefully against such a large resulting burden.[1] While we do not believe that burden has been met more generally, there are a few areas of the Proposed Rules in particular which we believe could be revised to minimize those costs.

First, we believe the Proposed Rules should contain an exclusion for service providers affiliated with advisers in light of the existing relationship between the advisers and service providers, as well as the additional background on the service providers that the advisers are already aware of because of the relationships. As a result, we believe that advisers already provide effective diligence of these service providers.

In addition, the Proposed Rules contain several definitions that ultimately require a facts and circumstances analysis by the adviser and the varying interpretations that will result may cause wide variations among advisers in determining which service providers are subject to the Proposed Rules. As a result, because of the adviser's ability to make the determination as to whether a service provider is in scope of the Proposed Rules, we believe the Proposed Rules should also contain a safe harbor for advisers which make a good-faith determination that the service provider engages in a covered function for the adviser, or if the service provider falls out of the scope of a covered function.

Finally, it will likely be challenging for advisers to obtain the necessary information required to diligence service providers, as well as the required contractual protections, to ensure that they would be complying with the Proposed Rules. If enacted, the Proposed Rules should contain a safe harbor for advisers that engage and contract with service providers with a good faith basis to comply with the Proposed Rules. In addition, if enacted, the Proposed Rules should, at a minimum, contain a grandfathering provision that would allow advisers to avoid having to renegotiate longstanding commercial agreements to enable the required protections, which would inevitably cause disruption to investors.

1. <u>Affiliated service providers should be excluded from the definition of service providers under the Proposed Rules.</u>

Affiliated service providers should be excluded from the Proposed Rules, which require an adviser to seek specific diligence information and assurances from a service provider and to prepare certain related records, because that information would already be known to the adviser based on the relationship, and the adviser and service provider would be under common control.[2] More

[1] In lieu of the Proposed Rules, we suggest the SEC could issue guidance similar to FINRA Notice 21-29 which provides general guidelines on service provider oversight. This notice provides that there is no one-size-fits-all approach to vendor management and related compliance obligations, and that firms should use risk-based approaches that may involve different levels of supervisory oversight, depending on the activity or function that vendors perform.

[2] While there could be situations in which affiliates have more distant relationships, they would constitute the exception. If the Staff believes that there is a need to account for such atypical circumstances, it should carefully tailor

specifically, the Proposed Rules would require an adviser to (i) identify the nature and scope of the covered function the service provider is to perform, (ii) identify and determine how it would mitigate and manage the potential risks to clients or the investment adviser's ability to perform its advisory services, (iii) determine that the service provider has the competence, capacity, and resources necessary to perform the covered function, (iv) determine if the service provider has any subcontracting arrangements, (v) obtain reasonable assurance from the service provider that it is able to, and will, coordinate with the adviser for purposes of the adviser's compliance with the Federal securities laws, and (vi) obtain 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. An adviser would also be required to follow certain related recordkeeping requirements.

For affiliated service providers, the due diligence requirements will result in an adviser requesting information that is already known to the adviser. For example, under the second element of due diligence, the proposing release notes that an adviser may consider identifying the risks of outsourcing to a particular service provider and that an adviser may review, among other items, a service provider's business continuity plan, policies and procedures, or results of periodic testing, or conducting periodic onsite visits. This information would already be familiar to the affiliate given the relationship and access to information because of it. The adviser and service provider may in fact already share policies and procedures and be located at the same site. Under the third element of due diligence, the proposing release notes that an adviser may focus on factors such as the experience and expertise of the service provider personnel and the comprehensiveness of its process and methodologies and gain an understanding of how the service provider will perform the covered function. The adviser will likewise already have this information for its affiliated service providers, through shared personnel, certain shared procedures, or other overlapping elements of their businesses.

The Proposed Rules would also require, under the fifth and sixth elements of due diligence, an adviser to obtain reasonable assurances from its service providers related to coordination with the adviser for purposes of the adviser's compliance with the Federal securities laws and a process for orderly termination of its performance of the covered function. Because the entities would be under common control and the adviser would have these assurances by virtue of the relationship, obtaining these assurances would be unnecessary and create paperwork and internal agreements without cause. The Proposed Rules' recordkeeping requirements would similarly compel an adviser to prepare and keep materials that either already exist or are not kept because they do not provide any benefit.

Complying with these due diligence and recordkeeping requirements for affiliates would not provide the adviser with additional knowledge but would impart significant compliance and recordkeeping burdens on it. For smaller advisers, complying with these regimented requirements

the rule as it applies to them to avoid otherwise imposing significant time and expenses on the majority of affiliates for which any such rule clearly should not apply.

would be a significant burden, whereas completing their own tailored due diligence would accomplish the same goal in an appropriate manner. For larger adviser complexes, there may be dozens of sub-advisory relationships requiring additional agreements and paperwork with significant costs with little to no benefit. As the Proposed Rules' required elements of diligence are, in many cases, requesting information that will already be known to the adviser, affiliated service providers should be excluded from the scope of the Proposed Rules.

2. <u>If enacted, the Proposed Rules should provide for a safe harbor for advisers that categorize "covered function" in good faith.</u>

A covered function is proposed to be defined as: (i) a function or service that is necessary for the adviser to provide its investment advisory services in compliance with the Federal securities laws, and (ii) 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. The determination of what serves as a covered function also would depend on the facts and circumstances, as the Proposed Rules are meant to encompass functions or services that are necessary for a particular adviser to provide its investment advisory services.

While we support relying on the judgment of the adviser, relying on a facts and circumstances determination leaves the definition open to an array of interpretations which may cause it to be challenging for advisers to determine how best to follow the Proposed Rules. In certain cases, for example, a service provider providing similar services could fall within the scope of the Proposed Rules for one adviser but not another or for the provision of one service but not another for the same adviser, depending on the relevant analysis.

As a result of the nature of the definition, which may lead to various potential interpretations, if the Proposed Rules are enacted, we request that the Commission provide a safe harbor provision for advisers which make a good-faith determination that the service provider is providing a covered or uncovered function. Such a provision would allow advisers and their counsel to make a best-efforts determination that they comply with any final rules, without the concern that their determinations might be second guessed on examination or otherwise. With a rule subject to multiple interpretations, advisers should be able to make reasonable good faith determinations without fear of reprisal with respect to other judgment calls.

3. <u>If enacted, we anticipate that it will be challenging for advisers to obtain the necessary diligence information and assurances from service providers in compliance with the Proposed Rules.</u>

The Proposed Rules require an adviser to comply with the six specific elements of due diligence previously detailed. The proposing release also notes that, although not required under the Proposed Rules, the adviser may want to obtain written assurances from the service provider related to the adviser's compliance with Federal securities laws and a process for orderly termination.

These elements of due diligence are likely to be difficult to comply with as service providers will likely be reluctant to provide details on proprietary aspects of the nature of their businesses and subcontracting arrangements, as well as the processes they have in place to mitigate risks. Relevant negotiations may be especially problematic for service providers that do not exclusively focus on the investment management industry and which may be reluctant to provide certain information and/or include these provisions in their form agreements.

Additionally, an adviser may enter into outsourced arrangements with service providers with substantially more bargaining power than the adviser, with some providing services to thousands of clients. Often these entities will require advisers to accept their form disclosure documents and agreements with little potential for the advisers to negotiate the terms. This will be particularly true for less established advisers or ones that have less assets under management.

As an important comparison point, in response to the Investment Adviser Marketing final rule adopted in December 2020 (the "Marketing Rule"), [3] advisers frequently encountered issues renegotiating placement agent agreements to comply with the Marketing Rule's new requirements, particularly for agreements with several large financial institutions that were unwilling to accept amendments to their form agreements. Because placement agent services do not directly impact the operations of a fund, but rather relate to the marketing of a fund, investment advisers had more optionality surrounding their ability to continue to engage in business with a provider when they were unable to agree on commercial terms. However, in the context of the service providers that would be covered by the Proposed Rules, it may be more difficult for advisers to refuse to do business with service providers to ensure compliance with any ultimate rule, as the services rendered may be necessary to the investment advisory services or already built into the day-to-day operations of the business. In the case that an adviser must replace the service provider for failing to comply with the Proposed Rules, it would be inefficient and costly to clients and investors for the adviser to change service providers. Advisers also often have agreements with as many as tens or hundreds of service providers, and requiring advisers to negotiate with and, if necessary, search for replacements for and replace a substantial number of service providers would divert significant time and energy away from services that directly benefit clients, and the management of any fund or client assets.

As a result, failure to agree to terms with a service provider could have a direct impact on the ability of an adviser and/or its funds to operate, causing disruptions for funds and their investors. This could also cause advisers to shift to service providers that accept the necessary contractual terms, but which are not familiar with, or may not provide services that are in the best interest of, the adviser or its funds or investors.

Due to the likely difficulties that advisers will encounter in entering into contracts with service providers in a manner to act in compliance with the Proposed Rules, if the Proposed Rules are

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[3] *See* Rule 206(4)-1(b) under the Investment Advisers Act.

enacted, we request that the Commission provide a safe harbor provision for advisers who make reasonable efforts to contract with service providers to carry out services in accordance with the Proposed Rules. This will allow advisers to continue to provide appropriate services while endeavoring to comply with any final rule.

4. If enacted, any final rule should include a grandfathering provision for already entered into service provider outsourcing agreements.

Given the nature of the services being contracted for and the complexity of service provider engagement and integration, it is possible that, for many service providers, existing agreements extend for long periods of time and that substantial time and effort has already been spent diligencing and negotiating the relevant agreements. Renegotiating agreements to seek the required terms would require a considerable use of advisers' resources.

In addition, it will be even more challenging, if not impossible, for an adviser to obtain the required contractual protections given the size and resources of many service providers once they are already working with those service providers. Once an adviser has already contracted with a service provider, and the service provider is integrated into an adviser's operations, the service provider has less incentive to provide the required diligence information, as there is a decreased chance that the adviser can walk away from the engagement without disruption to the adviser's operations if the service provider will not provide the required contractual terms. Advisers may not have the necessary leverage to request this information from service providers. Service providers may provide unique service arrangements or may be integrated into an adviser's existing processes. As a result, failure to agree to terms with a service provider could have a direct impact on the ability of an adviser and/or private funds it advises to operate, causing disruptions for funds and their investors. As noted above, this could also cause advisers to shift to other service providers which could also cause a disruption for funds or investors.

Because of the significant burden that the renegotiation of existing agreements would place on advisers, any final rule should include a grandfathering provision for existing service provider agreements. This would allow the industry time to adapt to the rules and avoid any disruption to clients and investors that would result from advisers having to renegotiate the service provider agreements. Requiring advisers to replace service providers with no grandfathering provision would be inefficient and costly to advisers' clients and their investors.

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Again, we thank you for the opportunity to provide these comments. If you have any questions regarding our comments, please feel free to contact Jason E. Brown at [redacted], or Joel A. Wattenbarger at [redacted].

Very truly yours,

Ropes & Gray LLP

/s/ Jason E. Brown
Jason E. Brown

/s/ Joel Wattenbarger
Joel Wattenbarger