BlackRock

December 27, 2022

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

*Submitted via email to rule-comments@sec.gov*

**Re: Outsourcing by Investment Advisers (File No. S7-25-22)**

Dear Ms. Countryman:

BlackRock, Inc. (together with its subsidiaries, "BlackRock")[1] respectfully submits the following response to the Securities and Exchange Commission's ("SEC") proposed rule "Outsourcing by Investment Advisers" (the "Proposal").[2]

Investment advisers have relied on service provider relationships for many years. Their decisions regarding whether to perform a function in-house or to retain a service provider reflect a combination of where their core expertise lies and considerations of control, risk profile, cost and scale. Virtually all investment advisers rely on service providers for at least some functions. Accordingly, we agree that robust service provider oversight is an important business practice for investment advisers. To this end, the Proposal describes considerations and steps that, in many cases, align with good practices for investment advisers when evaluating key service provider relationships, and BlackRock supports the Proposal's objective of promoting these practices.

At the same time, we believe that, as fiduciaries, investment advisers are currently subject to significant and meaningful obligations to conduct such oversight. In addition, investment advisers have substantial business and competitive incentives to prevent harm to clients and avoid disruptions in services. These existing obligations and incentives serve to promote appropriate, proportional vendor management practices. In contrast, the Proposal, by seeking to address services ranging from cloud storage to portfolio management with a single

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1 BlackRock manages assets on behalf of institutional and individual clients worldwide, across equity, fixed income, liquidity, real estate, alternatives, and multi-asset strategies. Our client base includes pension plans, endowments, foundations, charities, official institutions, insurers, and other financial institutions, as well as individuals around the world. BlackRock also offers Aladdin, an information processing platform that combines risk analytics with comprehensive portfolio management, trading and operations tools on a single, unified platform.

2 SEC, Outsourcing by Investment Advisers, 87 Fed. Reg. 68816 (November 16, 2022), available at https://www.govinfo.gov/content/pkg/FR-2022-11-16/pdf/2022-23694.pdf (the "Proposing Release").

set of requirements, may inhibit the development of innovative and risk-tiered diligence and oversight practices. Further, commercial standards for many types of services have developed over time to reflect negotiated understandings of each party's responsibilities and, in many cases, do not align with the proposed outsourcing requirements. As a result, we believe that the SEC should promote sound outsourcing and service provider oversight practices through its existing tools, which would allow each adviser more flexibility to determine approaches consistent with its own business circumstances and appropriate commercial standards, rather than through prescriptive rulemaking.

With these considerations in mind, we provide the following high-level recommendations, with more detailed recommendations on the Proposal in the sections below.

- **The Proposal is unnecessary in light of investment advisers' fiduciary duties and existing incentives; however, if the SEC moves forward, a principles-based approach in the form of guidance would be more effective than a prescriptive rule.** As discussed above, we believe that investment advisers' existing fiduciary duties, coupled with strong incentives to prevent disruption to their clients, align to obviate the need for a rule governing service provider oversight. We further believe that effective service provider oversight is and should continue to be risk-tiered, particularly in light of the variety of investment adviser business models and the variety of approaches advisers take with respect to utilizing service providers. Accordingly, if the SEC moves forward with policymaking concerning service provider oversight, we would urge it to replace the one-size-fits-all model in the Proposal with a principles-based approach that empowers investment advisers to continue crafting appropriately tailored, versatile practices that promote and further a risk-tiered approach.[3] Because the SEC's existing tools have and should continue to adequately address the responsibilities of investment advisers to conduct service provider oversight, a principles-based approach would best take the form of guidance.

- **Any final action should acknowledge and take account of the ways in which service providers mitigate risk for the benefit of clients and investors.** The Proposal states that the risk of outsourcing "is in addition to any risks that would exist from the adviser providing these functions."[4] This language suggests that advisers should assume that any decision to outsource represents an increase in risk. However, we respectfully submit that, compared to a scenario in which an adviser performs functions

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[3] *See also* BlackRock, Comments on Proposed Rule: Adviser Business Continuity and Transition Plans (September 6, 2016), available at https://www.sec.gov/comments/s7-13-16/s71316-30.pdf, in which we urged the Commission to take a principles-based approach to mandating that investment managers adopt a business continuity management program to facilitate the development of policies and procedures that are broadly applicable to the diverse range of adviser business models, as well as to account for the evolution of technology and market practices over time.

[4] Proposal at 68817.

internally, outsourcing often results in *reduced* risk, especially where cost-efficiency is an important factor. For example, service providers may provide investment advisers access to specialized proficiencies and capabilities that would be difficult or impossible for most investment advisers to hire, build or acquire on their own. Service providers also have economic incentives and the scale to invest in technology and innovations that would be prohibitively costly or otherwise impractical for individual investment advisers to develop in-house. Moreover, outsourcing can free investment advisers to focus their resources on the core competencies for which clients and investors principally look to them. These considerations, and the potential costs of the proposed rule, will likely be most acute for the smallest investment advisers. An overly prescriptive and burdensome regime could deter investment advisers from outsourcing functions in favor of building and maintaining internal solutions that could present greater risks than outsourcing would. Accordingly, we encourage the SEC to recognize that investment advisers, as fiduciaries, manage risks to their clients and advisory services both when outsourcing and when handling services in-house and to make clear in any guidance that it takes an agnostic view regarding the merits of outsourcing any particular service (or services generally).

- **The SEC should consider the significant impacts that the Proposal, and the lack of clarity in key terms, will have on service providers and, in turn, on the availability of services.** In addition to managing assets on behalf of clients, BlackRock provides a variety of services to investment advisers, including model portfolios and technology for risk analytics, portfolio management, trading and operations. From a service provider's perspective, BlackRock anticipates that the Proposal will impose significant burdens, to the detriment of advisers, service providers and, ultimately, advisory clients. Specifically, the prescriptive nature of the requirements, the number of service relationships covered and the departures from established commercial standards are likely to lead to service providers being inundated with requests and facing difficult decisions about taking on additional obligations and liability. This could, in turn, impose barriers to entry for new service providers, drive consolidation of service providers, result in increased costs and cause service providers to withdraw from the market. In addition, the Proposal's expansive and vague definition of "covered function," together with the significant consequences of mis-categorizing a function under an anti-fraud rule, are likely to drive advisers to a cautious and overly-inclusive approach to compliance. As a result, even service providers whose functions pose little actual risk to the businesses of advisers are likely to face requests for due diligence materials and revised contracts. The Proposal's treatment of model providers illustrates this clearly. Advisers use models in a variety of ways, with models serving in some cases as the basis for a portfolio and in others as simply a reference. Nevertheless, given the Proposal's repeated mention of models and unclear definitions, advisers using third-party models are likely to feel compelled to conduct diligence and seek assurances in most cases. As the Proposal acknowledges, "[e]xcessive oversight can result in costs to the adviser, and potentially its clients, that outweigh the intended benefits."

- **The SEC should carefully consider the downstream costs of the Proposal.** The Proposal would appear to require all investment advisers to conform their service provider diligence and contracting processes to a single standard. As a result, investment advisers and service providers will incur substantial costs. In many cases, these costs will represent the expense of setting aside organically-developed practices for a new, less-flexible standard, which may not yield tangible improvements in outcomes. Clients are likely to bear at least a portion of these additional costs, and the SEC should carefully consider whether the benefits to these clients will be commensurate. In some cases, the Proposal's expansive definition of "covered function" may cause investment advisers to worry that widely-used utilities, such as certain financial market infrastructures ("FMIs"), would be covered under the rule. An investment adviser may have no option but to engage with such FMIs, and, consequently, the FMIs may have little incentive to agree to the contractual assurances required by the Proposal. Advisers may incur significant costs attempting to negotiate the required due diligence and assurances or face increased potential liability under the proposed rule. For this reason, the SEC should explicitly exclude FMIs from the rule and address any concerns it has with the resiliency of these utilities directly.

If the SEC determines that adopting specific outsourcing requirements is necessary to advancing its goals, BlackRock believes that certain aspects of the Proposal should be revised to provide greater clarity of scope, improve efficiency, reduce costs and facilitate an orderly transition to the new framework, as discussed further below.

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## I. Scope of the Rule

As noted above, BlackRock agrees with the Commission that service provider oversight commensurate with the nature of the outsourced services is integral to an investment adviser's fulfillment of its fiduciary obligations. Establishing and maintaining an effective oversight program necessarily starts with identifying which service providers are appropriately captured by such a program. Unclear standards and definitions concerning the scope of relevant service providers creates risks both of under-inclusiveness and of over-inclusiveness (together with the potential for duplicative regulatory requirements). As such, we urge the Commission to provide greater clarity regarding which service providers and covered functions are within the scope of the rule. In addition, as discussed further below, we believe that the SEC should exclude affiliated service providers from the scope of the rule, given the existing incentives for those service providers to provide high-quality service and mitigate risk to clients and the affiliated adviser.

<u>Scope of "Service Providers" and "Covered Functions"</u>

The Proposal leaves considerable uncertainty with respect to which service providers and functions are in scope. We appreciate that the Commission may prefer a rule that captures a wide array of existing and potential future service providers. However, in its current form, we believe the Proposal leaves room for significant interpretive uncertainty that could result in inconsistent application and duplicative regulatory requirements. The risk posed by such uncertainty is that investment advisers' finite resources will be directed to activities that do not advance the Commission's aims.

For example, the Proposal's broad and open-ended definitions could capture arrangements that do not actually reflect "outsourcing"—*i.e.*, the delegation of a covered function to a third party. In reality, not every instance of an investment adviser's use of a service provider in connection with a covered function constitutes outsourcing. For example, an investment adviser may engage a consulting firm to review a component of the adviser's compliance program or a law firm to provide advice on matters relating to compliance with the Federal securities laws. Such an engagement, however, does not indicate that the investment adviser has "outsourced" its compliance function to the consulting firm or law firm. Accordingly, we believe that the SEC should more narrowly define the concepts of "service provider" and "covered function" to limit the scope to instances of actual outsourcing.

Further, the Proposing Release creates uncertainty by referencing a variety of undefined categories of function with little elaboration or illustration. For example, the Proposing Release cites "trade communication and allocation services" as a "potential covered function categor[y]."[5] This undefined concept, together with the significant consequences of violating an anti-fraud rule, could drive cautious interpretations that encompass myriad interactions with broker-dealers and other market participants that would not ordinarily be considered a form of outsourcing.[6] The SEC should remove or, at least, refine this category and provide clearer definitions for each category it retains.

The Proposal's treatment of model providers further illustrates the lack of clarity. As discussed above, investment advisers use models for an array of purposes ranging from guiding portfolio construction to serving as a single reference point in an adviser's research activities. Thus, while investment models may constitute covered functions for those investment advisers that rely on them to provide investment advice to their clients, that should not be the case for all advisers that use them. Nonetheless, the Proposal's treatment of model providers and the serious consequences if the SEC disagrees concerning an investment adviser's categorization of a function would likely drive many investment advisers

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5 *Id.* at 68821. The Proposal would also establish "Trade Communication and Allocation Services" as a category of service provider listed on Form ADV. *Id.* at 68883.

6 Similarly, the release explains that even service providers that the SEC otherwise regulates will not be excluded from the scope of the rule. For example, "if an adviser engages a broker-dealer to provide an electronic trading platform to submit orders from the adviser and allocate trades among the adviser's client accounts after the trades have been executed, then the adviser's engagement of the broker-dealer for those services would not be excepted from the proposed rule." Proposal at 68823. This vague description is, as discussed above, likely to drive advisers to worry that their relationships with broker-dealers may be covered functions, notwithstanding that the SEC generally already regulates both the adviser and the broker-dealer in that relationship.

to adopt an over-inclusive approach. This aspect of the rule could have a disproportionate impact on small and independent investment advisers, discouraging them from leveraging the expertise and resources of a model provider. Increasing the cost of these resources for small and independent investment advisers could dissuade individual professionals from pursuing their own businesses and push them toward affiliating with larger advisory firms, potentially reducing competition as well as choice for clients and investors.[7]

Accordingly, the SEC should provide greater clarity regarding the services that would constitute covered functions, even if that means narrowing the scope of the rule. The Proposal is designed in a manner that suggests the SEC is concerned with establishing a standard that covers all possible service arrangements that could pose risk to advisers and their clients, now and in the future. However, the resultant lack of specificity suggests that the SEC is, itself, not entirely certain how broadly it has cast its net. Accordingly, it is difficult, if not impossible, for the SEC and for commenters to anticipate all of the consequences of the proposed rule, other than to conclude that they will be far-reaching. While we understand the desire for an evergreen definition, a rule-based approach is not well suited to a loosely defined set of relationships, and principles-based guidance could more effectively address the SEC's goals. If the SEC retains the rule-based approach, it should narrow the definition of "covered function" to a succinct list of core services and trust in its existing tools and requirements as an effective and proven backstop.

Any final rule should also more clearly state that, if a client enters into an agreement with a service provider, the services to the client are not covered under the rule. While we believe that this was the SEC's intent, the Proposal primarily addresses this question indirectly, leaving room for uncertainty. For example, the SEC's statement that there may be potential overlap between the Proposal and Rule 38a-1 under the Investment Company Act of 1940, as amended (the "1940 Act"),[8] as well as certain questions that the Commission posed in the Proposing Release,[9]

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7 We further note that BlackRock and numerous other service providers make available, at no charge, investment analysis tools, with which a variety of users may interact, including investment advisers. These tools enable users to analyze various characteristics of a portfolio, and while these are not designed to allow investment advisers to outsource investment decisions, the vague and expansive definition of "covered function" may, again, cause investment advisers to either treat these tools as such or to stop interacting with a useful resource. We believe that any final rule or guidance adopted by the SEC should make clear that such investment analysis tools do not constitute covered functions.

8 *See id.* at 68874-75 ("Advisers may also consider the risks associated with the use of service providers when service providers are engaged on behalf of registered investment companies, which may be subject to other oversight rules under the Federal securities laws. For example, rule 38a-1 under the Investment Company Act requires certain compliance procedures and practices by registered investment companies including board approval of the policies and procedures of each adviser, principal underwriter, administrator, and transfer agent of the fund.").

9 *See Id*. at 68825 ("22. Should we provide an explicit exception for advisers when a registered investment company retains the listed service providers in rule 38a-1 under the Investment Company Act of 1940 (''Investment Company Act'') instead (i.e., principal underwriter, fund administrator, and transfer agent)? What about with respect to private funds, which are not subject to rule 38a-1?").

could give rise to confusion on this point. For example, the Proposal states that "custodians that are independently selected and retained through a written agreement directly with the client would not be covered by the [Proposal] *because the adviser is not retaining the service provider to perform a function that is necessary for the adviser to provide its advisory services*."[10] While such language strongly implies that a service provider retained by a client (such as a fund) rather than by the adviser, is outside of the scope of the Proposal, other language in the Proposing Release casts uncertainty on that point.[11]

The SEC should more explicitly acknowledge the important distinction between a service provider that enters into an agreement with an investment adviser and one that is retained by the adviser's client, whether that client is a separately managed account ("SMA") or a private or registered fund, and should clarify that any service provider that has an agreement with a fund or SMA is out of scope under the rule. Such service providers, in our view, are not properly covered by a rule under the Investment Advisers Act of 1940 (the "Advisers Act"), including because such service providers often perform functions that the fund or SMA's investment adviser was never retained to perform in the first instance. Moreover, advisers generally do not control the relationship between the client and its service providers.[12] In this regard, the rule should not specify a minimum approval standard by the board or other decision-maker in order for such service to be deemed out of scope. Similarly, where an SMA client retains a service provider, the investment adviser should not be responsible for conducting due diligence and monitoring unless it has undertaken to do so pursuant to a term in the advisory agreement (or another agreement between the client and the investment adviser). Where both an investment adviser and a fund or SMA client are parties to an agreement with a service provider, the SEC should clarify that only services provided to the investment adviser under the agreement could be covered functions.

Inclusion of Affiliated Service Providers

The Proposal would require investment advisers to conduct due diligence and monitoring of both unaffiliated and affiliated service providers, despite the existence of other risk mitigants applicable to affiliated service providers. We believe that the SEC should recognize that affiliated service providers are already incentivized to provide a high quality of service to the investment adviser, to coordinate on compliance and to take steps to mitigate the risk of disruption to

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10 *Id.* at 68821 (emphasis added).

11 For example, in the Proposing Release's economic analysis, the Commission states, "[a]s discussed above, custodians and marketers are not within the scope of the rule and so our analysis is limited to administrators." The discussion regarding custodians that this sentence appears to reference specifically relates to custodians that are retained by a fund. Accordingly, this statement could be interpreted to suggest that while custodians retained by a fund are out of scope of the Proposal, administrators retained by a fund are (or may be) in scope.

12 If the SEC is concerned about situations where a private fund adviser may have greater authority over the retention of a service provider by the fund, then it should at a minimum exclude service providers that enter into an agreement with a fund that has a board, limited partnership advisory committee, trustee or other decision-maker other than the adviser.

clients. In this regard, we note that the Commission has, in certain other contexts, recognized that affiliated entities do not present the same risk of disruption as unaffiliated entities because their interests are inherently aligned.[13] In our view, it is appropriate for the Commission to extend that rationale to the service provider context, recognizing that the moral hazards and similar types of concerns that may be present in arms-length relationships are sufficiently mitigated when the parties are affiliates.

Further, by not excluding affiliated entities that provide services to an investment adviser's clients, the Proposal draws a form-over-substance distinction, imposing different treatment on investment advisers whose affiliated service providers are separate legal entities from those with service providers that are housed in a separate business unit of the same entity. We believe that clients themselves do not give weight to such distinctions and, to the contrary, expect an investment adviser to draw on the resources of its broader organization and, in certain instances, may choose to engage an investment adviser *because* of the breadth of available resources at its disposal through its affiliates. Moreover, investment advisers are already required to disclose relationships with affiliated financial industry participants on Form ADV, which provides transparency for the SEC and advisory clients regarding an investment adviser's affiliations with potential service providers.[14] For these reasons, we respectfully submit that the SEC should exclude affiliated service providers from the scope of the rule.

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## II. Due Diligence, Reasonable Assurances and Monitoring Requirements

We are supportive of the Commission's goal to encourage every investment adviser to establish a robust oversight framework for outsourced service providers through initial due diligence and ongoing monitoring. As noted above, however, we strongly urge the Commission to adopt a principles-based approach in order to provide investment advisers with the flexibility to tailor their individual programs based on the investment adviser's particular characteristics and outsourcing arrangements. In addition, we believe the Commission should acknowledge that, for many investment advisers, outsourcing certain functions may better serve the aim of reducing risks to clients than would retaining those functions in-house,

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13 For example, Rule 12d1-4 under the 1940 Act, which the Commission adopted in 2020, prohibits an acquiring fund in a fund of funds structure that relies on that rule from controlling an acquired fund in which it invests and limits its ability to vote the shares of such an acquired fund. Rule 12d1-4, however, provides an exception from those restrictions in the case of an acquiring fund and acquired fund that are within the "same group of investment companies." In adopting Rule 12d1-4, the Commission observed that where an acquiring fund and acquired fund are advised by investment advisers that are affiliates of one another, "we do not believe that the acquiring fund adviser generally would seek to benefit the acquiring fund at the expense of the acquired fund." SEC, Fund of Funds Arrangements, 85 Fed. Reg. 73924 (Nov. 19, 2020), available at https://www.govinfo.gov/content/pkg/FR-2020-11-19/pdf/2020-23355.pdf.

14 *See* Form ADV, Item 7.A, Section 7.A of Schedule D.

which could require building and maintaining internal solutions that, for many advisers, will be less effective than those of dedicated service providers.

Due Diligence, Reasonable Assurances and Monitoring Requirements Should Take a Principles-Based Approach

Despite the array of service providers and investment advisers that the Proposal seeks to address, the Proposal would take a one-size-fits-all approach with respect to an investment adviser's obligations to conduct due diligence and monitoring and to obtain reasonable assurances. The SEC should recognize that, consistent with their fiduciary duties and Advisers Act requirements, investment advisers have established effective oversight processes that are appropriately tailored to the specific characteristics of their operations and their particular outsourcing arrangements. Such existing practices may include components such as risk assessments, contractual provisions, formal relationship structures, service level measurements, continuous monitoring best practices and other similar due diligence and governance mechanisms.[15] The SEC should revise its approach to allow investment advisers the flexibility to tailor their practices to fit the types of service providers retained and the functions being performed and to adopt a risk-tiered approach, with heightened diligence and monitoring measures in place for those service providers performing critical operational functions. The SEC should also recognize that certain service providers that provide covered functions are themselves registered investment advisers (such as many providers of investment models). These entities already make available extensive information through disclosure requirements on Form ADV and are subject to substantive regulation and examination by the SEC in their own right. Investment advisers should be permitted to leverage these factors in tailoring appropriate diligence and monitoring practices for service provides that are also registered advisers.

In addition, for a variety of reasons, investment advisers may face challenges in obtaining the precise information or assurances that the Proposal envisions. For example, service providers may be reluctant to undertake obligations to coordinate in support of the investment adviser's compliance with the Federal securities laws given the potential breadth of that undertaking. In addition, service providers that do not specialize in servicing the asset management industry (*e.g.*, a cloud data storage provider) may lack incentives to negotiate or may be reluctant to deviate from market practices that could affect many users aside from investment advisers. Standard commercial terms for many types of services provide for performance on an "as is" and "as available" basis. Many service providers also limit their liability to the amount of fees paid or a nominal sum, and many data service providers (such as index providers) strictly limit their obligations to licensees. Requiring investment advisers to negotiate for a different standard will discourage or hinder use of competent and cost-effective service providers. Even a large asset manager like BlackRock has limited ability to negotiate terms, especially for regulated services

15 *See* BlackRock, Discussion Paper on Regulatory and Supervisory Issues Relating to Outsourcing and Third-Party Relationships (Jan. 8, 2021), available at: https://www.blackrock.com/corporate/literature/publication/fsb-outsourcing-third-party-relationships-010821.pdf.

like electronic communication networks ("ECNs"), where the ECN rulebook applies to all participants and the service provider is registered with the SEC. Accordingly, the SEC should take a more principles-based approach to the due diligence and monitoring obligations and consider removing the reasonable assurances provisions of the Proposal, which we discuss in greater detail below.

Identifying and Mitigating Risk

The SEC, in discussing the requirements to identify and determine how to mitigate potential risks, does not account for the risk of managing all aspects of a complex business without the support of service providers. The Proposal states that the risk of outsourcing "is in addition to any risks that would exist from the adviser providing these functions."[16] This language suggests that advisers should evaluate this due diligence requirement under the assumption that any decision to outsource represents an increase in risk. As discussed above, however, the base case of an adviser performing every function internally may actually present greater risks in many respects.

Vendors often have the scale to dedicate resources to specific functions, bringing specialized expertise and risk management to those areas that asset managers may not have the resources or proficiency to develop in-house. For example, it may be impossible or uneconomical for every investment adviser to hire staff with specialized experience, but a service provider may be able to take advantage of efficiencies to employ a specialist or even a team of specialists. This may be true in a variety of areas, particularly newer fields, like data science or artificial intelligence, where the demand for talent exceeds the supply. Each of those specialists may also bring to bear experience and insights gained through working with numerous advisers, to the benefit of the contracting investment adviser. Similarly, economies of scale exist where a service provider makes investments in systems and technology capable of providing services to many users.

Moreover, many of the risks of outsourcing that the SEC identifies have parallels within advisers. Even if an investment adviser employs its own staff for a function, that staff may quit, underperform or be insufficient for the demands of the business. In contrast, due to their scale, service providers can more efficiently offer redundancy in personnel, mitigating the impact of employee turnover.

In addition, outsourcing can improve an investment adviser's resiliency by reducing its potential switching costs. When an investment adviser engages a service provider, it often goes through an onboarding process that involves defining requirements, documenting the services provided and organizing relevant data. This process, together with the experience of working with a service provider, may better prepare an investment adviser to work with subsequent service providers. In contrast, an investment adviser that has never used a service provider

[16] Proposal at 68817.

for a function and finds that its internal resources are inadequate or underperforming may face a slower and more expensive transition.

Accordingly, we believe that the SEC should expressly affirm that an investment adviser, in evaluating the potential risks of outsourcing a particular function, can weigh those risks against the potential risks associated with not outsourcing. Doing so would reduce the risk that investment advisers would interpret the Rule as disapproving of or dissuading the use of outsourcing and enable investment advisers to consider the appropriate balance for their individual businesses.

Finally, the SEC should reasonably calibrate its expectations for risk mitigation. For example, if the Rule requires, in effect, redundancy of every key service, as suggested by the proposal,[17] the costs would be substantial. These costs would also be most acutely felt among smaller advisers. The Commission should made clear that there is not an expectation that an investment adviser would need to establish redundancy with respect to outsourced services or functions. An investment adviser should also be able to consider the adequacy of a service provider's own operational resiliency measures as a risk mitigating factor.

Contractual Considerations in Obtaining Reasonable Assurances

The Proposal would require investment advisers to negotiate specific contract provisions with service providers, and to renegotiate existing service agreements, to obtain certain "reasonable assurances." The Proposal would also extend this requirement, with additional assurances required, to third-party recordkeepers by amending Rule 204-2 under the Advisers Act.[18] Obtaining these assurances would be possible only with the willingness and cooperation of service providers—many of whom would not be subject to or familiar with the Proposal or similar rules, especially where their businesses are not focused on serving investment advisers. In addition, the reasonable assurances provisions are unclear and could be read to require extensive or open-ended undertakings. Where a service provider is unwilling to amend an existing service agreement in a manner consistent with the Proposal's requirements, an investment adviser's fund and other clients could face disruption if the investment adviser is thereby forced to insource the related covered function or identify an alternative service provider to perform it. Even where service providers are willing to offer such assurances, they may see the assurances as increasing their potential liability, which would likely increase the costs of services for advisers and clients. The SEC should consider removing the reasonable assurances provisions of the Proposal (including the reasonable assurances in the proposed amendments to Rule 204-2) to reduce these potential risks and costs.

In some instances, investment advisers have no choice but to engage with specific utilities. For example, there are a variety of FMIs on which all market participants rely, such as exchanges, central clearing counterparties, electronic

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17 *Id.* at 68829.

18 *Id.* at 68872.

trading and affirmation platforms and trade messaging systems. Given the breadth of the Proposal's scope, it is possible that an FMI could be deemed to be providing a covered function. FMIs, however, may have little incentive to submit to an investment adviser's demand for the contractual assurances contemplated by the Proposal, as the FMI may be the only or the most significant provider in the market. Accordingly, the SEC should revise the proposed rule to carve out FMIs and could more effectively advance its goals by using its authority to address any concerns it has with these utilities—which generally are already subject to its oversight—directly.

The Proposal also would require an investment adviser to obtain reasonable assurances that a service provider will provide a process for orderly termination of its services.[19] As discussed above, this requirement does not align to market standards for the provision of many of the covered services. The SEC should reasonably calibrate its expectations for how quickly a service provider transition could occur, acknowledging that even in a base case without outsourcing, an investment adviser's ability to hire new personnel, purchase new equipment or build new systems is also likely to take a considerable amount of time and expense.

## III. Compliance Period

The Proposal's 10-month period for investment advisers to come into compliance provides little time for thousands of investment advisers to update procedures, conduct due diligence and renegotiate contracts with a vast array of service providers. We believe this will prove too short both for investment advisers and for service providers. The resulting burdens are likely to prove most challenging for small investment advisers and small service providers, potentially exacerbating barriers to entry and incentivizing consolidation among both advisers and service providers.

From the perspective of a service provider, we would expect to be inundated with new diligence requests from investment advisers that engage us, particularly given that existing arrangements are not grandfathered under the Proposal. Further, investment advisers may have differing needs or expectations, requiring bespoke responses. Responding to these requests could require changes to existing systems or the extensive hiring of additional staff. As noted above, in many cases, aspects of the rule could require amending existing service agreements, which would require significant time and resources. In the case of large service providers, these activities could involve interaction and negotiation with thousands of investment advisers. Some service providers, particularly those who are not focused on advisers (*e.g.*, cloud storage providers) might determine that having investment advisers as clients is no longer in their interests or might increase the fees that will be borne by advisers and their clients to compensate for the increased time and effort in helping advisers meet their obligations under the rule.

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[19] *Id.* at 68826 ("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.")

Further, the SEC should recognize that implementation of the Proposal would coincide with the likely implementation periods of numerous other recently adopted or proposed SEC rules applicable to investment advisers and their clients. Each of these will require considerable resources to implement and are likely to draw from similar legal, compliance, operational and other business resources.[20] A lengthier compliance period would facilitate the orderly, thoughtful implementation of the Proposal as well as other SEC rules.

We believe that, in addition to lengthening the compliance period, the Commission should consider a phased implementation approach. For example, the compliance period could commence two years after adoption of a final rule and end three years after adoption, with new service arrangements subject to the provisions starting at the end of year two but existing contracts needing to be addressed only by the end of year three. This may, for example, allow more of the proposed rule's requirements to be addressed through normal renewal cycles than a rapid implementation process. Overall, a phased implementation approach would better enable investment advisers and service providers to thoughtfully implement the rule's requirements while reducing burdens and allowing time for standard practices to emerge in the market.

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We thank the Commission for providing BlackRock the opportunity to express our support for your efforts and to provide our comments and suggestions on the Proposal. Please contact the undersigned if you have any questions or comments regarding BlackRock's views.

Sincerely,

Kathryn Fulton
Head of the U.S. Public Policy Group

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[20] *See e.g.*, SEC, Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews, 87 Fed. Reg. 16886 (March 24, 2022), available at https://www.govinfo.gov/content/pkg/FR-2022-03-24/pdf/2022-03212.pdf; SEC, Investment Adviser Marketing, 86 Fed. Reg. 13024 (Mar. 5, 2021), available at https://www.govinfo.gov/content/pkg/FR-2021-03-05/pdf/2020-28868.pdf; SEC, Tailored Shareholder Reports for Mutual Funds and Exchange-Traded Funds; Fee Information in Investment Company Advertisements, 87 Fed. Reg. 72758 (November 25, 2022), available at https://www.govinfo.gov/content/pkg/FR-2022-11-25/pdf/2022-23756.pdf; SEC, Open-End Fund Liquidity Risk Management Programs and Swing Pricing; Form N-PORT Reporting, available at https://www.sec.gov/rules/proposed/2022/33-11130.pdf (not yet published); SEC, Money Market Fund Reforms, 87 Fed. Reg. 7248 (Feb. 8, 2022), available at https://www.govinfo.gov/content/pkg/FR-2022-02-08/pdf/2021-27532.pdf; SEC, Enhanced Disclosures by Certain Investment Advisers and Investment Companies About Environmental, Social, and Governance Investment Practices, 87 Fed. Reg. 36654 (June 17, 2022), available at https://www.govinfo.gov/content/pkg/FR-2022-06-17/pdf/2022-11718.pdf; SEC, Investment Company Names, 87 Fed. Reg. 36594 (June 17, 2022), available at https://www.govinfo.gov/content/pkg/FR-2022-06-17/pdf/2022-11742.pdf.

cc:

The Honorable Gary Gensler
Chairman
Securities and Exchange Commission

The Honorable Hester M. Peirce
Commissioner
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The Honorable Jaime Lizárraga
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