

Outsourcing by Investment Advisers



The Securities and Exchange Commission will consider proposing a new rule and related amendments to prohibit SEC-registered investment advisers from outsourcing certain services or functions to service providers without meeting minimum requirements. The proposal includes:

- New requirements for advisers to conduct due diligence before outsourcing and to periodically monitor service providers' performance and reassess whether to retain them;
- Related requirements for advisers to make and/or keep books and records related to the due diligence and monitoring requirements;
- Amendments to the adviser registration form, Form ADV, to collect census-type information about advisers' use of service providers; and
- A requirement for advisers to conduct due diligence and monitoring for third-party recordkeepers, along with a requirement to obtain reasonable assurances that the third-party will meet certain standards.

Why This Matters

Many advisers engage service providers to perform functions that can benefit advisers and their clients in a number of ways, such as providing investment guidelines, portfolio management, models related to investment advice, indexes, or trading services or software. There is a risk that investors could be harmed, however, when an adviser outsources a function that is necessary for the provision of advisory services without appropriate adviser oversight. The Commission has observed an increase in advisers outsourcing and issues related to the outsourcing and advisers' oversight. More needs to be done to protect investors and to enhance the oversight of these outsourced functions.

How The Rule and Amendments Would Apply

Create a Framework for Service Provider Oversight Across Advisers

New proposed rule 206(4)-11 would establish an oversight framework across SEC-registered advisers that outsource a "covered function"; that is, a function or service that: (1) is necessary to provide advisory services in compliance with the Federal securities laws, and (2) 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. Clerical, ministerial, utility, and general office functions or services would be explicitly excluded from the proposed rule.

Before retaining a service provider to perform a covered function, an adviser would be required to reasonably identify and determine through due diligence that outsourcing the covered function to that service provider would be appropriate by considering:

- The nature and scope of the covered function;
- Potential risks resulting from the service provider performing the covered function, including how to mitigate and manage such risks;
- The service provider's competence, capacity, and resources necessary to perform the covered function;
- The service provider's material subcontracting arrangements related to the covered function;
- Coordination with the service provider for Federal securities law compliance; and
- The orderly termination of the performance of the covered function.

The proposal also would require the adviser periodically to monitor the service provider's performance and to reassess the selection of the service provider under the due diligence requirements of the rule. Additionally, the adviser would have to make and keep books and records related to its due diligence and monitoring and to report census-type information about these service providers on Form ADV.

Enhanced Oversight of Third-Party Record Keepers

The proposal would require an adviser that relies on a third-party recordkeeper to conduct due diligence and monitoring of that third party consistent with the requirements under proposed rule 206(4)-11. The proposal also would require advisers to obtain reasonable assurances that the third party will meet four standards, which address the third party's ability to:

- Adopt and implement internal processes and/or systems for making and/or keeping records that meet the requirements of the recordkeeping rule applicable to the books and records being maintained on behalf of the adviser;
- Make and/or keep records that meet all of the requirements of the recordkeeping rule applicable to the adviser;
- Provide access to electronic records; and
- Ensure the continued availability of records if the third party's relationship with the adviser or its operations cease.

Additional Information:

If proposed, the public comment period will remain open for 60 days after the date of issuance and publication on [sec.gov](https://www.sec.gov) or 30 days after publication in the Federal Register or, whichever period is longer.