

# SEC Proposes Oversight and Disclosure Requirements for Services Outsourced by Investment Advisers

## Investment Services Group Client Alert

On October 26, 2022, the Securities and Exchange Commission (SEC) proposed a new rule that would require registered investment advisers to conduct due diligence prior to hiring a service provider to perform “covered functions” and to periodically monitor the performance of the service provider and reassess the retention of the service provider. Proposed amendments to Form ADV would require advisers to collect and report “census-type” information on these service providers, and amendments to the books and records rule would require advisers to keep and maintain records related to compliance with the new requirements.

Under the proposed rule, covered functions are functions or services that (1) are necessary for an investment adviser to provide its services in compliance with federal securities laws and (2) “if not performed or performed negligently, would be reasonably likely to cause a material negative impact” to the adviser’s clients or to the adviser’s provision of advisory services. Index providers are specifically referenced as potentially relevant service providers, although whether an index is relied on in the investment decision-making process or used for performance comparison would be relevant in determining whether the services concerned constitute a covered function. By way of example, compliance services would likely be covered, while marketing and soliciting would not. “[C]lerical, ministerial, utility, or general office functions or services” would not be considered covered functions. However, a third-party recordkeeper would be treated as a “service provider” performing a “covered function”—and the proposal would require enhanced oversight thereof, requiring advisers to obtain “reasonable assurances” that the recordkeeper will meet specific standards.

The proposed rule does not distinguish between third-party service providers and affiliated service providers. A service provider is defined as “a person or entity that: (1) performs one or more covered functions; and (2) is not a supervised person of the adviser.” There is no exception under the proposed rule for service providers that are otherwise subject to regulation under other provisions of the federal securities laws.

The proposed due diligence element of the new rule would require an investment adviser “to reasonably identify and determine that it would be appropriate to outsource the covered function, that it would be appropriate to select the service provider, and once selected, that it is appropriate to continue to outsource the covered function.” Once an adviser has engaged a service provider, the proposed rule would require periodic monitoring of the service provider’s performance based on the due diligence requirements “with a manner and frequency such that the adviser can reasonably determine that it is appropriate to continue to outsource the covered function” to the service provider.

Comments on the proposed rule are due 30 days after the date of publication in the Federal Register or December 27, 2022, whichever is later.

The SEC’s proposing release is available [here](#).

Please contact a member of Vedder Price’s [Investment Services Group](#) if you have any questions.

More information about the Investment Services Group is available [here](#). Click [here](#) for recent ISG publications.