National Association of Private Fund Managers

May 3, 2024

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

Via email to rule-comments@sec.gov

Re: Outsourcing by Investment Advisers
Release No. IA-6176; File No. S7-25-22

Dear Ms. Countryman:

The National Association of Private Fund Managers, Alternative Investment Management Association, American Investment Council, Loan Syndications and Trading Association, Managed Funds Association, and National Venture Capital Association submit this letter in further response[1] to the request of the Securities and Exchange Commission (the "Commission") for comment on the proposed rules published in Release No. IA-5955, File No. S7-03-22 (the "Proposed Rules"). *See* 87 Fed. Reg. 68,816 (Nov. 16, 2022). We appreciate the opportunity to provide comments and perspective on the Proposed Rules.

We write to highlight an overarching defect in the Proposed Rules: the Commission lacks statutory authority to apply the Proposed Rules to investment advisers with respect to their services to private funds. As with other recent rulemakings,[2] the Commission advances the Proposed Rules under sections 206(4) and 211(h) of the Investment Advisers Act, 15 U.S.C.

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[1] *See, e.g.*, Letter from Managed Funds Association & National Association of Private Fund Managers, File No. S7-03-22 (July 21, 2023), *available at* sec.gov/comments/s7-25-22/s72522-233021-486802.pdf; Letter from Managed Funds Association, File No. S7-25-22 (Dec. 20, 2022), *available at* sec.gov/comments/s7-25-22/s72522-20153177-320682.pdf; Letter from Alternative Investment Management Association, File No. S7-25-22 (Dec. 19, 2022), *available at* sec.gov/comments/s7-25-22/s72522-20153080-320640.pdf; Letter from American Investment Council, File No. S7-25-22 (Dec. 22, 2022), *available at* sec.gov/comments/s7-25-22/s72522-20153419-320841.pdf; Letter from Loan Syndications and Trading Association, File No. S7-25-22 (Dec. 20, 2022), *available at* sec.gov/comments/s7-25-22/s72522-20153224-320700.pdf.

[2] *See Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews*, 88 Fed. Reg. 63,206 (Sept. 14, 2023).

§§ 80b-6(4), 80b-11(h). *See* 87 Fed. Reg. at 68,873/1. Neither provision, however, grants the Commission rulemaking authority over the internal affairs of private funds.

As the Association has previously explained, including in pending litigation, *see Nat'l Ass'n of Private Fund Managers v. SEC*, No. 23-60471 (5th Cir.), the Commission's assertion of authority over investment advisers' relationships with private funds contravenes the statutory framework governing such funds. Congress deliberately excluded private funds from regulation under the Investment Company Act. Thus, by congressional design, private funds are—unlike retail-oriented funds governed by the Investment Company Act—exempt from federal regulation of their internal "governance structure," *Chamber of Com. v. SEC*, 412 F.3d 133, 139 (D.C. Cir. 2005), including "advisers' oversight" of vendors and other operational matters, 87 Fed. Reg. at 68,819. Indeed, when Congress wants to subject contractual relationships to special oversight or conditions, it says so explicitly—just as it did with respect to investment companies but not private funds. *See, e.g.*, 15 U.S.C. § 80a-15(c) (requiring investment company boards to review and approve advisory contracts). Here, by prohibiting private fund managers from retaining service providers unless they adhere to the strict conditions set forth in the Proposed Rules, the Commission seeks to meddle in the internal affairs of private funds, thereby undoing Congress's deliberate decision to exempt private funds from precisely that sort of intrusive regulation. The internal affairs of private funds, to be sure, may be subject to agreements negotiated within the parameters of state limited partnership acts. *See* Unif. Ltd. P'ship Act § 105 cmt. (2013) (the "limited partnership's partnership agreement" governs "all matters constituting 'internal affairs'"). But that is an issue of state, not federal, law. The Commission has no authority to meddle in the "internal affairs" of state-law partnerships, *i.e.*, private funds. *See Bus. Roundtable v. SEC*, 905 F.2d 406, 412 (D.C. Cir. 1990) ("except where federal law expressly" says otherwise, "investors commit their funds" to entities on "the understanding" that state law "govern[s]" the entity's "internal affairs" (quoting *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 479 (1977))).

The Commission points to section 211(h) of the Advisers Act, *see* 87 Fed. Reg. at 68,873/1, but that section, adopted in section 913 of the Dodd-Frank Act, has nothing to do with private funds. From stem to stern, its "undeniable focus" is the "standards of conduct as they apply to retail investors." Dissent of Comm'r Peirce, (Aug. 23, 2023), bit.ly/44WDa0J.

Section 913 is titled "Study and Rulemaking Regarding Obligations of Brokers, Dealers, and Investment Advisers," Dodd-Frank § 913, 124 Stat. 1376, 1824 (2010), and both the "Study" and "Rulemaking" concern "retail customers." The section instructs the Commission to analyze the "effectiveness" of legal protections concerning recommendations "to retail customers," § 913(b)(1), 124 Stat. at 1824-25, and identifies thirteen specific items to "consider," all of which concern "retail customers," § 913(c), 124 Stat. at 1825-27. The section further instructs the Commission to draft a "report" about "retail customers," § 913(d), 124 Stat. at 1827, and authorizes the agency to "commence a rulemaking" addressing protections for "retail customers," § 913(f), 124 Stat. at 1827-28. This has nothing to do with private funds.

The Commission turns to one sentence tacked onto the end of section 913(g), codified at 15 U.S.C. § 80b-11(h)(2), *see* 87 Fed. Reg. at 68,873/1, which uses the word "investors." But

Congress switched to "investors" in that sentence because it refers to interactions (*e.g.*, "sales practices") between financial professionals and retail investors "*before* they become customers," Peirce, *supra* (emphasis added); as the Commission has recognized, switching from "customer" to "investor" indicates an intent to reach "an earlier stage" of the retail relationship, *Form CRS Relationship Summary*, 84 Fed. Reg. 33,492, 33,542/2 (July 12, 2019). Congress did not switch to investor "in the middle of a provision otherwise devoted" to retail investment, *Schreiber v. Burlington N., Inc.*, 472 U.S. 1, 12 (1985), to grant the Commission sweeping authority over private funds.

In any event, the provision the Commission relies on applies only to "certain sales practices, conflicts of interest, and compensation schemes." 15 U.S.C. § 80b-11(h)(2). But the Commission does not, and cannot, explain how engaging a third-party service provider is a "sales practice," "conflict of interest," or "compensation scheme." The Proposed Rule is completely devoid of statutory authority.

Section 206(4) of the Advisers Act, also cited by the Commission, *see* 87 Fed. Reg. at 68,873/1, does not change the analysis. Section 206(4) authorizes the Commission to "prescribe means reasonably designed to prevent" "fraudulent, deceptive, or manipulative" "acts, practices, and courses of businesses." 15 U.S.C. § 80b-6(4). To begin, "reasonable design" requires a "sensible" fit within the "statutory context," *Ascendium Educ. Sols., Inc. v. Cardona*, 78 F.4th 470, 482 (D.C. Cir. 2023)—a "close nexus" with the "statutory aims," *United States v. O'Hagan*, 521 U.S. 642, 676 (1997). That nexus is absent here because the Proposed Rule contravenes the statutory design on numerous levels. *See supra* p 2.

In addition, the Proposed Rules have nothing to do with fraud. The Commission pays lip service to the "reduced risk of fraud associated with outsourced functions," 87 Fed. Reg. at 68,858/2, but in no way articulates a "rational connection between" fraud and any particular requirement the Commission "cho[se]" to adopt. *Motor Vehicle Mfrs. Ass'n, Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983). The Commission does not cite any evidence that outsourcing-related "fraud" is a problem, and it makes no effort to explain how the Proposed Rules would prevent "fraud" in the first place. Disrupting the business of *all* private-fund advisers (and many others) to target a non-existent problem is not "reasonable design." 15 U.S.C. § 80b-6(4).

For these and numerous other reasons, the Proposed Rules should not apply to investment advisers with respect to their services to private funds.

Respectfully submitted,

NATIONAL ASSOCIATION OF PRIVATE FUND MANAGERS

ALTERNATIVE INVESTMENT MANAGEMENT ASSOCIATION

AMERICAN INVESTMENT COUNCIL

LOAN SYNDICATIONS AND TRADING ASSOCIATION

MANAGED FUNDS ASSOCIATION

NATIONAL VENTURE CAPITAL ASSOCIATION