July 9, 2024

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

Via email to rule-comments@sec.gov

Re: Cybersecurity Risk Management for Investment Advisers, Registered Investment Companies, and Business Development Companies, Release Nos. 33–11028; 34–94197; IA–5956; IC–34497; File No. S7–04–22

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

Conflicts of Interest Associated With the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers, Release Nos. 34–97990; IA–6353; File No. S7–12–23

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, National Venture Capital Association submit this letter in further response to the request of the Securities and Exchange Commission ("**SEC**" or "**Commission**") for comment on the above referenced proposed rules ("**Proposed Rules**").[1] We appreciate the opportunity to provide comments and perspective on the Proposed Rules.

This letter is a follow up to a letter [we] previously submitted to the Commission on the Outsourcing Proposal, in which we argued the Commission lacked statutory authority to apply the proposed rule to investment advisers with

[1] *See* Cybersecurity Risk Management for Investment Advisers, Registered Investment Companies, and Business Development Companies, 87 Fed. Reg. 13524 (Mar. 9, 2022) ("**Cybersecurity Proposal**"); Outsourcing by Investment Advisers, 87 Fed. Reg. 68,816 (Oct. 26, 2022) ("**Outsourcing Proposal**"); and Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers, 88 Fed. Reg. 53,960 (Aug. 9, 2023) ("**Predictive Data Analytics Proposal**").

respect to their services to private funds.[2] Since then, as the Commission is aware, the Fifth Circuit Court of Appeals reached a decision in *National Association of Private Fund Managers v. SEC*, No. 23-60471 (5th Cir. June 5, 2024), holding that the Commission exceeded its statutory authority in adopting the private fund adviser rule. Specifically, the court held that neither section 211(h) nor section 206(4) of the Investment Advisers Act of 1940 ("**Advisers Act**") grants the Commission rulemaking authority to cover the relationship between private fund advisers and investors in the funds they advise. "By congressional design," the court recognized, "private funds are exempt from federal regulation of their internal 'governance structure.'"[3]

In light of the holding in *National Association of Private Fund Managers*, we respectfully urge the Commission to withdraw the Proposed Rules given the limits of its authority under section 206(4). In the event that the Proposed Rules are not withdrawn, we urge the Commission to make clear that the Predictive Data Analytics Proposal, the Outsourcing Proposal, and the Cybersecurity Proposal are not applicable to investment advisers with respect to any client that is not a "retail customer" in line with the Court's holding that "section 211(h) applies to 'retail customers,' and thus, the Commission exceeded its statutory authority in relying on that section to adopt the [Private Fund Adviser] Rule."[4]

Predictive Data Analytics Proposal

The Commission issued the Predictive Data Analytics Proposal under authority in section 211(h) of the Advisers Act. However, as noted above, in *National Association of Private Fund Managers*, the Fifth Circuit held that section 211(h) applies to "retail customers." Similarly, the Commission does not have authority to apply the Predictive Data Analytics Proposal to investment advisers' relationships with clients that are not "retail customers" under section 211(h). For this reason, we believe the Predictive Data Analytics Proposal should be withdrawn.

Outsourcing and Cybersecurity Proposals

The Commission advanced the Outsourcing and Cybersecurity Proposals under sections 206(4) and 211(h). As the Fifth Circuit determined, however, neither

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[2] *See* Letter from 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 to Vanessa Countryman, Secretary, SEC (May 3, 2024) ("**Outsourcing Authority Letter**"), available at: https://www.sec.gov/comments/s7-25-22/s72522-466611-1236294.pdf.

[3] *Nat'l Assoc. of Private Fund Managers v. SEC*, No. 23-60471 (5th Cir. June 5, 2024) at [20] (citing *Chamber of Comm. v. SEC*, 412 F.3d 139, 139 (D.C. Cir. 2005)).

[4] *Id.* at [22].

provision grants the Commission rulemaking authority to adopt these proposals. Based on the holding in *National Association of Private Fund Managers,* the Commission should not adopt these proposals.

As to Section 211(h), the court's determination regarding the application of that provision to retail customers only should be dispositive. As to Section 206(4), and as the court determined, that provision authorizes the Commission only to "prescribe means reasonably designed to prevent" "fraudulent, deceptive, or manipulative" "acts, practices, and courses of businesses." But, as the court held, "the Commission cannot promulgate rules under the guise of section 206(4) that affect [the] internal governance structure of private funds."[5] Moreover, section 206(4) specifically requires the Commission to "define" an act, practice, or course of business that is "fraudulent, deceptive, or manipulative" before the Commission can prescribe "means reasonably designed to prevent" "such" act, practice, or course of business. A "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) and a "close nexus" with the "statutory aims," *United States v. O'Hagan*, 521 U.S. 642, 676 (1997).

The Outsourcing Proposal is not about fraud.[6] We are concerned that 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 propose. *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 the potential for 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 investment advisers to target a non-existent problem is not "reasonable design." Similarly, in the Cybersecurity Proposal, the Commission points to potential risks of cybersecurity practices but does not identify any specific fraud the rule is designed to address.[7] The Commission also does not articulate a "rational connection" between the Cybersecurity Proposal and the fraud which the Commission has failed to identify.

In addition, as we previously noted (and fully consistent with the decision in *National Association of Private Fund Managers, supra*), by congressional design, private funds are exempt from federal regulation of their internal "governance structure," including "advisers' oversight" of vendors and other operational matters.

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[5] *Id.* at [24].

[6] *See* Outsourcing Authority Letter at 3.

[7] See *Nat'l Assoc. of Private Fund Managers v. SEC,* No. 23-60471 (5th Cir. June 5, 2024) at [23] (finding the Commission's "vague assertions" to fall short of the definitional specificity that Congress has required in section 206(4)).

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.[8] By prohibiting private fund managers from retaining service providers unless they adhere to the strict conditions set forth in the Outsourcing and the Cybersecurity Proposals, the Commission seeks to affect the internal affairs of private funds, thereby undoing Congress's deliberate decision to exempt private funds from precisely that sort of intrusive regulation.[9]

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For these and numerous other reasons, we urge the Commission to withdraw the Predictive Data Analytics, Outsourcing, and Cybersecurity Proposals. At a minimum, the Commission should reconsider its authority to promulgate the Outsourcing and Cybersecurity Proposals under section 206(4). If the Proposed Rules are not withdrawn as requested, they should not apply to investment advisers with respect to their services to clients that are not "retail customers" under the purported authority of Section 211(h), and should not apply to investment advisers with respect to their services to private funds under the purported authority of Section 206(4).

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