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September 6, 2016

Submitted electronically

Mr. Brent Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-9303

Re: **Adviser Business Continuity and Transition Plans – File No. S7-13-16**

Dear Mr. Fields:

Vanguard¹ appreciates the opportunity to provide comments to the Securities and Exchange Commission (the “Commission”) on its recent proposal regarding adviser business continuity and transition planning.² Vanguard supports the stated goals of the Proposing Release to: (i) facilitate robust business continuity and transition planning; and (ii) to mitigate operational and other risks associated with a significant disruption in an adviser’s operations. We believe that the investing public and individual industry participants will benefit from robust industry-wide business continuity planning. Moreover, Vanguard believes that the Commission is the appropriate regulator to address advisers’ business continuity and transition plans (“BCPs”).

Since the adoption in 2003 of Rule 206(4)-7 under the Investment Advisers Act of 1940, as amended (the “Advisers Act”)³, advisers have incorporated BCPs into their required compliance policies and procedures.⁴ Vanguard supports the Commission’s efforts to further ensure that advisers have adequate

¹ The Vanguard Group, Inc. is an SEC-registered adviser that offers more than 350 funds with aggregate assets of approximately \$3.6 trillion. Through our affiliates, Vanguard Advisers, Inc., Vanguard Global Advisers, LLC, Vanguard Asset Management, Ltd., and Vanguard Investments Australia, Ltd., each a Commission-registered adviser, we provide one-time advice and ongoing management to retail clients, institutional clients, and participants of eligible employer-sponsored retirement plans; interactive advice tools; model portfolios; and fund management and/or advisory services to pooled investment vehicles that are not registered mutual funds and certain separate accounts. Collectively, Vanguard’s registered advisers will be referred to herein as “Vanguard.”

² *Adviser Business Continuity and Transition Plans*, 81 Fed. Reg. 43530 (July 5, 2016) (the “Proposing Release”).

³ *See Compliance Programs of Investment Companies and Investment Advisers*, IA Release No. 2204, 68 Fed. Reg. 74713 (Dec. 24, 2003) (the “Compliance Program Adopting Release”).

⁴ Since the adoption of Rule 206(4)-7, significant events have tested the efficacy of advisers’ BCPs and the industry has generally performed well. In 2012, for example, Hurricane Sandy tested Vanguard’s BCP. We were able to effectively respond to the challenges at hand because we anticipated that such a complex event might occur, prepared a thorough and flexible response plan, and practiced the response long before the actual event. This work included preparation for the possibilities of loss of workspace, employee unavailability, disruptions to communication channels, impacts on third-party service providers, and market closures. Such planning allowed us to effectively respond to these fast-moving threats and avoid significant impact on clients.

policies and procedures in place to manage business continuity and transition events.⁵ We believe that the proposed rule is an important part of the Commission's ongoing efforts to address concerns expressed with respect to operational risk in the asset management industry.⁶ Accordingly, we support the proposed rule with certain modifications and observations discussed more fully below.

I. Executive Summary

- **Vanguard supports the Commission's rulemaking in this area because it advances the Commission's efforts to protect investors. The Commission's proposal requires an adviser to tailor its BCP to mitigate the risks applicable to its specific business, thereby allowing advisers to adopt BCPs specifically tailored to protect their clients' interests.** Vanguard believes the Commission has struck an appropriate balance between a prescriptive approach that may become stale in a shifting risk environment, and the more general requirement of Rule 206(4)-7 under which advisers historically have adopted BCPs. We note that the testing and ongoing development of such plans is an important part of BCPs, and the Commission's approach enhances investor protection by requiring an adviser to focus its efforts on identifying and mitigating risks to the adviser's individual lines of business. Vanguard suggests that any final rule contain language that expressly permits advisers to tailor their BCPs in light of their businesses and the attendant operational risks. Consistent with the Commission's proposed approach, Vanguard also believes that any final rule should make clear that advisers are permitted to rely on an enterprise-wide BCP program.
- **Vanguard believes that the Commission should not construe the occurrence of a business disruption or continuity planning deficiency as *per se* fraudulent, and that advisers should not be insurers against all disruptions or guarantors of third party performance.** The language in the Proposing Release is overreaching to the extent that it can be read to suggest that an adviser has engaged in a fraudulent practice in violation of Section 206 of the Advisers Act if a business disruption occurs despite an adviser's efforts to mitigate such risks. The Proposing Release correctly notes that advisers may not be able to prevent significant business disruptions under certain circumstances, and any final rule should clarify that advisers will not be subject to regulatory liability for business disruptions if they have taken reasonable steps to address business continuity and transition planning risks.
- **Business continuity plans, and information regarding their implementation in routine or immaterial circumstances, should not be required to be filed with the Commission or provided to advisory clients.** Business continuity plans are proprietary and disclosure to the Commission or clients could subject advisers to increased operational risks. In addition, business continuity planning evolves rapidly and any requirement to file BCPs would not benefit the Commission because those plans would likely include stale information. Any requirement whereby advisers are required to notify the Commission or clients of activation of their BCPs should contain

⁵ See *Vanguard Comment Letter to the Financial Stability Oversight Council* (Mar. 25, 2015), available at https://pressroom.vanguard.com/nonindexed/Vanguard_FSOC_Letter_3.25.2015.pdf ("Vanguard FSOC Comment Letter").

⁶ See *Financial Stability Oversight Council, Update on Review of Asset Management Products and Activities* (April 18, 2016), available at <https://treasury.gov/initiatives/fsoc/news/Documents/FSOC%20Update%20on%20Review%20of%20Asset%20Management%20Products%20and%20Activities.pdf>.

a materiality threshold to avoid reporting of routine matters or matters where BCPs successfully mitigate business disruptions.

A more detailed discussion of each of these points follows.

II. Vanguard Supports the Commission’s Proposed Risk-Based Standard

Vanguard supports the Commission’s rulemaking in this area. We further support the Commission’s efforts to propose a rule that is specifically tailored to the asset management industry and that will meaningfully enhance investor protection. The varied nature of advisory business models requires an approach to business continuity and transition planning that takes into account these variations.

- a. A risk-based approach protects investors by recognizing differences in planning necessitated by the iterative nature of business continuity and transition planning and differences dictated by business lines

The Proposing Release notes that disparate business continuity practices exist among advisers and states that the proposed rule would require an adviser to take into account “the risks associated with its particular operations, including the nature and complexity of the adviser’s business, its clients and its key personnel.”⁷ Vanguard supports this approach. The iterative nature of business continuity and transition planning is best served by a regulatory framework that takes into account differences in advisers’ lines of business and the attendant business continuity risks associated therewith. As we have previously stated, “[t]he purpose of business continuity plans is to develop alternative ways to carry out normal business functions without access to facilities, systems, and/or key third party providers of goods or services to the funds or its adviser. Business continuity planning is an ongoing process – compliance, audit, and enterprise risk professionals are dedicated to constantly troubleshooting possible contingency scenarios and engaging with business leaders to prioritize business continuity initiatives, update business continuity plans, and engage in business continuity drills.”⁸

Further, business continuity events can generally be placed into broad categories related to: (i) the unavailability of physical facilities or workspaces; (ii) technology disruptions; (iii) third-party service provider disruptions; and (iv) the unavailability of personnel. While Vanguard believes it would be inefficient to include detailed BCP requirements in any final rule because of the rapidly changing risk environment and differences among adviser business lines, the components included in the Proposed Rule identify appropriate standards to address these broad categories into which business continuity disruptions generally fall. Transition planning further serves as an excellent example of the highly individualized nature of BCPs, which must necessarily vary by business line. While a sole proprietor registered adviser may be able to designate a successor in contemplation of a future transition, advance selection of a successor adviser is not possible for a registered investment company due to the nature of the regulatory requirements applicable to its advisory agreements, including the necessity to obtain board and/or shareholder approval of any change in investment adviser.⁹ Consequently, we agree with the Commission that proper business continuity planning must necessarily be based upon the specific operations and risks applicable to each individual adviser. We believe the Proposed Rule strikes an appropriate balance between the specific components that should be included in BCPs as identified in subsection (b)(2) of the Proposed Rule, and

⁷ *Proposing Release* at 43538.

⁸ *Vanguard FSOC Comment Letter* at 23.

⁹ *See e.g., Section 15(a) of the Investment Company Act of 1940, as amended, 15 U.S.C. § 80a-15(a).*

the flexibility advisers require to establish BCPs that accommodate the different risks associated with their diverse business models.

Nevertheless, we believe the Commission should consider adopting explicit language in any final rule to address whether an adviser has determined that a particular BCP component is unnecessary or inapplicable. FINRA Rule 4370, the business continuity requirement imposed on FINRA member firms, is instructive on this point as it incorporates qualifications requiring each member firm to address specific enumerated categories to the extent they are relevant to the firm's operations.¹⁰ Rule 4370 provides, "[e]ach member must address [such] categories to the extent applicable and necessary. If any of the [enumerated] categories is not applicable, the member's business continuity plan need not address the category. The member's business continuity plan, however, must document the rationale for not including such category in its plan."¹¹ Vanguard supports the inclusion of similar language in any final rule.¹² Vanguard would also support a requirement for an adviser to affirmatively disclose to the Commission and its clients whether any of the particular elements of subsection (b)(2) of the Proposed Rule were purposefully excluded from its BCPs, and its reasons for making this determination. Disclosures could be delivered by adding a new section to Form ADV Part 2(a). Requiring advisers to disclose to the Commission and clients that their BCPs do not include some of the enumerated components and their reasons for not including such components would provide meaningful information about BCPs and an adviser's assessment of various operational risks to its business.

b. Allowing advisers to rely on an enterprise-wide BCP program benefits advisory clients

Vanguard believes that the Commission should also provide that advisers may rely upon, or be covered by, enterprise-wide business continuity programs, so long as those programs otherwise meet the requirements of any final rule. In our experience, our advisory clients are best served when business continuity planning is approached from an enterprise-wide perspective. Firms with multiple advisory entities or business lines necessarily involve leaders across numerous functions, such as technology, operations, compliance, audit, facilities management, legal, and enterprise risk, in developing, refining and testing BCPs. The utilization of those collective resources and broader organizational thinking makes BCPs stronger, which benefits clients and investors. By contrast, requiring every registered adviser within a complex to adopt its own separate policies and procedures, and to maintain such policies and procedures as part of its books and records, would be duplicative and provide no incremental benefit to clients. Accordingly, we urge the Commission to make clear that advisers may rely upon either enterprise-wide plans or plans created to cover specific business lines or affiliates to the extent they comply with the terms and provisions of any final rule.

III. Business Continuity Disruptions And Planning Deficiencies Are Not *Per Se* Fraudulent, And Advisers Are Not Insurers Against All Disruptions Or Guarantors of Third Party Performance

We are troubled by the fact that the Commission seeks to promulgate the proposed rule as an antifraud measure under Section 206 of the Advisers Act, as we believe it is inappropriate to characterize a BCP that, in hindsight, did not perform as planned as somehow perpetrating a fraud on clients. While there may be instances when a failure to take reasonable steps to mitigate the risk of a business disruption may

¹⁰ See FINRA Rule 4370(c) (2015), available at http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=8625.

¹¹ *Id.*

¹² Consistent with this approach, Vanguard nevertheless believes that any adopting release should specify that any specific examples of BCPs contained therein relating to particular operations, systems, vendors, et cetera, are included exclusively for purposes of guidance.

be inconsistent with an adviser's fiduciary duty, gaps in business continuity and transition planning or the mere occurrence of a disruption should not be construed as *per se* fraudulent. Vanguard suggests that the Commission adopt this rule under the recordkeeping requirements of Section 204 of the Advisers Act or as a "stand alone" rule adopted pursuant to Section 211(a) of the Advisers Act or, if it proceeds under Section 206, clarify that the Commission would not interpret a business continuity event or planning deficiency as *per se* fraudulent.

Some of the language used in the Proposing Release is concerning, insofar as the Commission states that an adviser may commit fraud by not taking "steps to protect clients' interests from being placed at risk as a result of the adviser's inability (whether temporary or permanent) to provide [advisory] services."¹³ This language is overreaching because it implies that fraud claims may be lodged in situations where disruptions occur despite the fact that a firm adopted a reasonable BCP. Later in the release, the Commission correctly recognizes that advisers may not be able to prevent significant business disruptions arising out of natural disasters, terrorist attacks, or third-party service provider disruptions.¹⁴ While we agree with the Commission that advisers should take reasonable steps to mitigate known potential disruptions, identify critical third-party service providers (both internal and external), and ensure that such third-parties have adopted appropriate BCPs, we believe it is important for the Commission to acknowledge that the proposed rule does not render advisers insurers or guarantors against business disruptions. Rather, the Commission should make clear that an adviser's obligation is to develop plans designed to reasonably respond to disruptions, to conduct reasonable due diligence to satisfy itself that its third-party service providers have appropriate BCPs, and to establish reasonable redundancies or back-up plans for third party service providers where it is reasonable to do so.

IV. Business Continuity Plans, And Information Regarding Their Implementation in Routine or Immaterial Circumstances, Should Not Be Filed With the Commission or Provided to Clients

The Proposing Release seeks comment on whether BCPs, or a summary thereof, should be filed with the Commission or disclosed to clients.¹⁵ The Proposing Release also seeks comment on whether advisers should be required to notify the Commission or clients of incidents where BCPs have been implemented.¹⁶ We believe that a requirement to disclose full BCPs to the Commission or to clients could lead to increased operational risks and administrative burdens without any corresponding benefits. As a result, we strongly support the Commission's decision not to include such requirements in the text of the proposed rule. Regarding the notification to the Commission or clients about the activation of a BCP, Vanguard believes that a meaningful requirement must include some form of materiality threshold.

- a. BCPs are proprietary in nature and their full disclosure to the Commission or the public could lead to increased risks to advisers and clients

As the Proposing Release notes, BCPs contain proprietary and sensitive processes and procedures, the public disclosure of which may enhance advisers' vulnerabilities to disruptions.¹⁷ For example, if we were required to disclose Vanguard's precise methods for dealing with a technology disruption, such as the

¹³ See *Proposing Release* at 43532.

¹⁴ See *Id.* at 43534.

¹⁵ See *Id.* at 43544.

¹⁶ See *Id.*

¹⁷ See *Id.* at 43550.

nature of the redundancies and backup systems that Vanguard utilizes, that information could be used by a wrongdoer to disrupt those redundancies and backup systems, thereby leading to a more extensive and prolonged disruption. Similarly, widespread communication about alternate workspaces for critical business operations could put those operations at continued risk. Either of these scenarios has the potential to increase the risk of harm to investors.

As the Proposing Release also notes, business continuity planning is an ongoing process.¹⁸ Vanguard's enterprise risk management professionals constantly review business continuity scenarios in an effort to troubleshoot contingency scenarios, prioritize business continuity initiatives, and incorporate the latest thinking and continuity technology into our BCP. This ongoing process relates to numerous internal systems and processes, as well as internal and external service providers, and results in a constantly evolving program. Therefore, we believe any requirement to summarize or otherwise file this constantly evolving proprietary program with the Commission or disclose it to the public would result in an undue administrative burden that would not provide meaningful disclosure, in addition to the operational risks highlighted above. Any benefit to filing or otherwise disclosing advisers' BCPs to the Commission or the public, therefore, is significantly outweighed by the risks of such disclosure, and we agree with the approach taken by the Commission to not incorporate such requirements into the draft rule.

b. Advisers should not be required to notify the Commission or clients each time a BCP plan is invoked

The Proposing Release seeks comment on whether an adviser should be required to report incidents when it relies on its BCP to the Commission or its clients.¹⁹ We would not support a requirement to report *all* incidents involving implementation of BCPs because of the significant administrative burden such a requirement would impose. Nevertheless, Vanguard recognizes that notification to the Commission and clients may be necessary in certain scenarios. We, therefore, encourage the Commission to incorporate some standard of materiality in the event that reporting will become an aspect of any final rule.

As referenced above, business continuity planning, particularly for advisers to registered investment companies or for those with multiple business lines, generally involves numerous internal systems and processes, as well as internal and external service providers. Each of those systems may involve some aspect of contingency planning that, if subject to a disruption, would result in implementation of an adviser's BCP or a portion thereof. Such an implementation will not always necessarily involve a major service disruption or other incident that materially impacts an adviser's ability to provide services to its clients. Requiring reporting in all instances will unnecessarily divert firm resources away from the mitigation of disruptions and provide little benefit to the Commission or clients.

For example, a heavy snowstorm or technology disruption involving an adviser's office may necessitate implementation of some aspect of an adviser's BCP. However, to the extent the BCP works as intended, such an event is unlikely to cause a significant disruption in the adviser's business and its ability to service its clients. There are many additional examples of events for which the industry has developed detailed playbooks within their BCPs – for example, an unanticipated market close – where the successful mitigation of disruption makes reporting unnecessary. Those types of events could occur relatively frequently in light of the breadth of businesses, systems, and processes that BCPs are intended to address. Under those circumstances, it would be administratively burdensome for an adviser to have to track and report to the Commission or its clients each time some aspect of its BCP is implemented. As a result, Vanguard would not support such a reporting requirement. In the event that a reporting requirement is

¹⁸ See *Id.* at 43544.

¹⁹ See *Id.*

included in any final rule, the Commission should define a materiality standard in a manner that avoids the need to report routine matters or matters where the successful activation of a firm's BCP has mitigated the business interruption to such an extent that notification to the Commission or clients would serve no regulatory purpose.

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V. Conclusion

We appreciate the opportunity to comment on the Commission's proposals. If you have any questions about Vanguard's comments or would like any additional information, please contact Tara Buckley, Senior Counsel, at [REDACTED], or Sandra Burke, Principal, at [REDACTED].

Sincerely,

/s/ Chris D. McIsaac

Chris D. McIsaac
Managing Director, Planning and Development

cc: The Honorable Mary Jo White, Chair
The Honorable Kara M. Stein, Commissioner
The Honorable Michael S. Piwowar, Commissioner
David Grim, Director, Division of Investment Management