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16 September 2016

Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Business Continuity and Transition Plans (File No. S7-13-16)

Dear Mr. Fields:

CFA Institute[1] appreciates the opportunity to comment on the Securities and Exchange Commission's (SEC or Commission) proposal to require all SEC-registered investment advisers to implement and maintain written business continuity and transition plans in accordance with specified requirements. CFA Institute represents the views of those investment professionals who are its members before standard setters, regulatory authorities, and legislative bodies worldwide about issues affecting the practice of financial analysis and investment management, education and licensing requirements for investment professionals, and on issues affecting the efficiency, integrity and accountability of global financial markets.

Executive Summary

Goal of proposal: We agree that the proposed rules are intended to achieve important objectives and support efforts by advisers to prepare for smooth transitioning in times of business disruptions and transitions. However, we question the need for new regulations to the degree mandated in the proposal.

Alternative. Instead of creating a new set of regulations, we believe that an overarching regulatory mandate accompanied by guidance is a better alternative. This hybrid-approach would impose a regulatory requirement on advisers to adopt and implement a business continuity plan but the specific components that should be addressed through those plans would come in the form of SEC-issued guidance. This would obligate the adviser to commit to adopting and implementing a plan that reasonably addresses the risks of its specific business without the overlay of additional regulations, the cost of which ultimately may be borne by investors.

[1] CFA Institute is a global, not-for-profit professional association of more than 133,000 investment analysts, advisers, portfolio managers, and other investment professionals in 151 countries, of which more than 125,500 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 147 member societies in 73 countries and territories.

Discussion

Through this release, the SEC is proposing to create new Rule 206(4)-4 under the Investment Advisers Act of 1940 under which it would be unlawful for an adviser registered with the SEC to provide investment advice without a business continuity and transition plan that it reviews annually. Amendments to existing Rule 204-2 would impose recordkeeping requirements upon the adviser relating to those plans.

We appreciate and support the SEC's concerns that investor interests be protected in cases of a significant interruption in the business of is investment adviser—be it through cyberattacks, technological problems, loss of data or access to the primary office, natural disasters or other external occurrences that would interrupt the smooth operations of the adviser and servicing of the client accounts. Similarly, investor interests should be safeguarded in instances where advisers may be unable to sufficiently service client accounts during business transitions by the adviser as it winds down its business or engages in a merger or other reorganization. With over $67 trillion in assets being managed by advisers, we understand the potential risk that these disconnects may carry for investors.

Thus, we strongly support the overriding goal to protect investors and their accounts in times of stress and change. However, it is true that registered investment advisers generally have already established continuity plans which are regularly examined and assessed as part of the SEC periodic exam process. Moreover, there is little evidence that advisers failed to manage investor interests—even during times of severe stress during the financial crisis—or compelling arguments of the likelihood of future disruptions that will so severely impact investors. We therefore question the need for widely expanded requirements in this regard.

In light of our attention to the SEC's Disclosure Effectiveness Initiative and recent efforts to reduce duplicative regulations, we are mindful of the need to streamline the regulatory structure wherever possible, without sacrificing investor protections. Moreover, as regulators encourage industry participants to contain the costs that are passed on to investors, we believe they will need to consider whether the regulatory objective already is being met without the creation of additional regulation, as some estimate that advisers will need to reduce overall costs to around 50 basis points within five years to remain competitive.

To that end, we suggest that the SEC adopt a single regulatory requirement that advisers create and maintain business continuity plans and provide guidance addressing the particular components that should be included in those plans. The release advises that advisers already fall under a general fiduciary duty to provide systems to service client accounts, in addition to recent compliance programs that impose more specific requirements. We also note the recognition in the release that the proposed regulations will create additional costs for advisers that may well be passed on to investors.

We believe that advisers already take to heart the seriousness of having business continuity plans in place. This hybrid approach of a regulatory mandate with guidance will emphasize the responsibility to implement the plans, while allowing advisers the flexibility to tailor those plans in accordance with the specifics of their businesses.

Business Continuity Plans

As proposed, advisers would be responsible for creating and maintaining a business continuity plan (BCP) that "is reasonably designed to address operational and other risks related to a significant disruption in an adviser's operations." The written business continuity plan would have to include specific components that address:

- Maintenance of critical operations and systems, and the protection, backup and recovery of data;
- Pre-arranged alternate physical locations(s) of the adviser's office(s) and/or employees;
- Communications with clients, employees, service providers and regulators;
- Identification and assessment of third-party services critical to the operation of the adviser; and
- Plan of transition that accounts for the possible winding down of the adviser's business or the transition of the adviser's business to others in the event the adviser is unable to continue providing advisory services (plan of transition has a list of its own required policies and procedures).

In accordance with these components, for example, if the adviser relies on "a particular service provider for a critical service," the adviser would be responsible for knowing if the "provider has a BCP and if that BCP provides alternatives, including backup plans, to allow it to continue providing critical services during a significant business disruption." The adviser would also need to generally review and assess how the critical services providers it arranges and /or oversees for its clients plan to maintain business continuity during times of significant disruptions and how that planning will affect the operations of its clients.

Transition Plans

One part of the duty to create a business continuity plan requires the adviser to create and implement its policies for a plan of transition, which would have to include:

- Policies and procedures intended to safeguard, transfer and/or distribute client assets during transition;
- Policies and procedures facilitating the prompt generation of any client-specific information necessary to transition each client account;
- Information regarding the corporate governance structure of the adviser;
- The identification of any material financial resources available to the adviser; and

- An assessment of the applicable law and contractual obligations governing the adviser and its clients, including pooled investment vehicles, implicated by the adviser's transition.

As proposed, transition plans would need to address transitions during normal, as well as stressed, conditions.

Specific Comments

We do not take issue with the list of the specific components that advisers should address when formulating their plans and agree that advisers would want to consider them in the context of their business when formulating a BCP. With respect to transition plans, we agree with staff that advisers appear to handle routine and non-routine transitions of client accounts without significant disruption to the business, in large part because client assets are held not by the adviser but through a third-party custodian. Yet, there have been instances, of course, where transitions have not been seamless.

We believe it is important to ensure, to the degree possible, that advisers consider all relevant factors in devising their BCPs, including transition plans. However, we believe this objective can be addressed through a single regulatory requirement to *create* the plans, accompanied by *guidance* as to the specifics that should be included in those plans.

Existing Regulations

Staff notes in this release that advisers' fiduciary duty already requires them to "take steps to protect client interests from being placed at risk as a result of the adviser's inability to provide advisory services," which extend to risks connected to business continuity and transition issues. Under this interpretation, the investment advisory industry is on notice that it bears a responsibility for the safeguarding of client assets and the smooth transitioning or servicing of client accounts and that it is subject to enforcement action for failures in its system. Given that the release further notes that it would be "fraudulent and deceptive" [under section 206(4) of the Advisers Act] "for an adviser to hold itself out as providing advisory services unless it has taken steps to protect clients' interests from being placed at risk as a result of the adviser's inability (whether temporary or permanent) to provide those services," we believe that advisers will take this responsibility seriously.

The proposal requires advisers to have plans that are "reasonably designed." Yet, regulations requiring specific components to be part of the design may lead to severe and unanticipated consequences. For example, under this "fraudulent and deceptive" approach to an adviser's duty we question whether advisers, who believe they have reasonably designed such a program, will still be subject to enforcement actions for fraud and deceit should they fail to consider one of the specific components to the degree enforcement thought was necessary.

The release additionally notes that the SEC has already adopted Rule 206(4)-7 that "addressed business continuity planning…in a general way" by requiring advisers to adopt and implement written policies and procedures aimed at preventing violations of the Advisers Act, including an obligation to address business continuity plans to the degree they were relevant. While this rule may not have required the specifics of such plans, as this rule proposes, it appears to create the overarching obligation on behalf of advisers, that could be supplemented by official guidance.

In addition, existing rules adopted by FINRA require brokers to adopt many of the particulars being proposed as part of these business continuity plans, although the provisions are not in all respects identical. As a consequence, brokers and advisers will be required to operate under two sets of regulations, which may be duplicative and not always consistent.

Basis for proposal

We believe that our suggestion for guidance rather than the creation of specific regulatory requirements is further supported by language in the proposal itself. In the release, staff notes that there have been few occurrences of the type which the proposed rules are designed to prevent, even during the turbulent times stemming from the financial crisis and other extraordinary times. Moreover, staff advises in the release that occurrences that would trigger use of the continuity plans would be rare. Despite the infrequency of business disruptions that have required extraordinary measures, however, many advisers have already implemented plans to mitigate against such risks as a direct prudent business practice and in recognition of the reputational harm they stand to suffer by not having in place such safeguards. Thus, in a sense, the industry has already started self-regulating in response to not just the challenges learned from the financial crisis, but from occurrences since, such as flooding from tropical storms, cyber-attacks on business and government databases, and perceived shortcomings in current systems.

Instead of the prevalence of definable threats, staff concerns appear to be focused on the lack of information on the degree to which these plans already exist. While staff understands that many advisers have implemented good BCPs, others may not have, and staff's ability to discern the degree of robustness across the sphere of advisers is lacking. Moreover, staff notes that there may be inconsistencies among advisers that have already implemented good plans.

We appreciate these concerns. We believe, however, that the concern that advisers implement adequate BCPs can be accomplished without the degree of regulation being proposed. A clear requirement to have such plans in place in accordance with guidance that details the components that should be considered should provide advisers with the details they need, while placing them on notice that they risk sanctions should they fail to comply. This release alone sounds an alarm to advisers that insufficient programs may lead them open to charges of fraud—not something advisers take lightly.

Costs and Benefits

In the Economic Analysis section of the proposal, staff also notes several things that appear to support consideration of an alternative to this proposal.

In particular, in analyzing the costs and benefits, as well as the effects on efficiency, and capital formation, staff notes that “in certain cases, we were unable to quantify the economic effects because we lack the information necessary to provide reasonable estimates, such as the extent to which some advisers already have business continuity or transition plans that would satisfy some or all of the requirements of the proposed rule, the likelihood of business disruptions, and the share of costs arising from the proposed rule that advisers will pass through to its clients.” The release also states that “the types of business disruptions addressed by this proposal are infrequent” and “transition events, like business disruptions, are relatively rare.” It also notes the difficultly of determining the estimated costs for investors due to the variations in advisers’ existing BCPs and the degree to which they will need to be revised, but that generally it appears that larger advisers have already devoted resources to develop the plans.

Regardless of the degree to which advisers may already have BCPs in place, additional costs associated with a regulation will most likely have a correlated cost for investors. While unable to quantify such an amount, the release does note that “it is likely at least some of the cost increases of the proposed rule will be passed on to clients and investors.” We therefore urge consideration of alternatives aimed at accomplishing the recognized objective without incurring unnecessary costs.

Conclusion

While we agree that advisers should create and implement business continuity plans, we believe this can be accomplished through a single regulatory requirement accompanied by guidance that will provide advisers with reasonable flexibility and reduce correlated costs. Should you have any questions about our positions, please do not hesitate to contact Kurt N. Schacht, CFA at [redacted], [redacted] or Linda Rittenhouse at [redacted], [redacted].

Sincerely,

/s/ Kurt N. Schacht

Kurt N. Schacht, CFA
Managing Director, Standards and Advocacy
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/s/ Linda L. Rittenhouse

Linda L. Rittenhouse
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