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SEC PROPOSES BUSINESS CONTINUITY AND TRANSITION PLAN REQUIREMENTS FOR INVESTMENT ADVISERS; STAFF ISSUES GUIDANCE FOR REGISTERED FUNDS

August 2016

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On June 28, 2016, the US Securities and Exchange Commission (SEC) proposed new Rule 206(4)-4 (Proposed Rule) under the Investment Advisers Act of 1940, as amended (Advisers Act) and also proposed amendments to certain existing rules, which would focus on registered investment advisers' preparedness for business continuity events.[1] The Proposed Rule is the fourth in a series of five core regulatory initiatives aimed at the asset management industry.[2] Staff in the SEC's Division of Investment Management concurrently released IM Guidance Update 2016-04 (Guidance), which emphasizes the importance for registered investment companies to mitigate operational risks related to significant business disruptions.[3]

The Proposed Rule and parallel Guidance from the SEC staff reminds registered funds of the importance of business continuity planning.

PROPOSED RULE ON BUSINESS CONTINUITY AND TRANSITION PLANS

Background

Business continuity and transition plans (BCPs) are designed to help investment advisers continue to provide advisory services in the event of temporary or permanent business disruptions such as natural disasters, cyberattacks, technology failures, and departures of key personnel.[4]

In its release announcing the Proposed Rule and amendments regarding business continuity (Proposing Release), the SEC noted that the financial services industry is increasingly complex and that investment advisers now rely on technology more than ever to manage complicated portfolios and strategies that often include complex investments.[5] The SEC also noted that the asset management industry relies heavily on outsourced service providers such as custodians, broker-dealers, pricing services, and technology vendors to support investment advisers' back-office and middle-office operations. According to the SEC, the fact that one firm's financial distress can have a broad impact on the financial markets—as illustrated during the financial crisis of 2008 and ensuing "Great Recession" in the United States—

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[1] *See* Adviser Business Continuity and Transition Plans, Investment Advisers Act Rel. No. 4439 (June 28, 2016), Adviser Business Continuity and Transition Plans, 81 C.F.R. 43,530 (July 5, 2016) (hereinafter, Proposing Release). It is worth noting that the Proposed Rule falls under Section 206(4) of the Advisers Act, which generally prohibits an adviser from engaging in certain fraudulent, deceptive, or manipulative acts or practices. Throughout the Proposing Release, the SEC reiterates its view that an adviser that holds itself out as providing advisory services—but which had not taken appropriate steps to implement a BCP—would be committing a fraudulent or deceptive act.

[2] *See* Speech by SEC Chair Mary Jo White, Enhancing Risk Monitoring and Regulatory Safeguards for the Asset Management Industry (Dec. 11, 2014) (outlining regulatory initiatives). In May 2015, the SEC proposed changes designed to modernize investment adviser and investment company reporting requirements. *See* Investment Company Reporting Modernization, Investment Company Act Rel. No. 31,610 (May 20, 2015); Amendments to Form ADV and Investment Advisers Act Rules, Investment Advisers Act Rel. No. 4091 (May 20, 2015). Next, in September 2015, the SEC proposed certain liquidity management requirements for registered investment companies. *See* Open-End Fund Liquidity Risk Management Programs; Swing Pricing, Investment Company Act Rel. No. 31,835 (Sep. 22, 2015). Third, the SEC proposed new regulations of registered investment companies' use of derivatives and other financial commitment transactions. *See* Use of Derivatives by Registered Investment Companies, Investment Company Act Rel. No. 31,933 (Dec. 11, 2015). According to Chair White's speech, the next proposal after this Proposed Rule would require enhanced stress testing requirements for large advisers and large funds. Morgan Lewis has prepared materials on each of these proposals, including a LawFlash on the Reporting Modernization Proposal, a LawFlash on the Liquidity Proposal, and a White Paper on the SEC's Derivatives Proposal.

[3] *See* Business Continuity Planning for Registered Investment Companies, IM Guidance Update No. 2016-04 (June 2016).

[4] In the Proposing Release, the SEC differentiates between "external events" (such as a weather-related emergency or cyberattack), "internal events" (such as a facility problem at an investment adviser's primary office location), and "transition events" (such as an investment adviser winding down or ceasing operations during a time of stress).

[5] *See* Proposing Release *at* pg. 5 (stating that there are approximately 12,000 SEC-registered investment advisers that collectively manage over $67 trillion in assets—up 140% in past 10 years).

supports the need for advance planning for an orderly resolution of disruptive events.[6] These aspects of the modern asset management business are the basis for the SEC's proposal to formally require all registered investment advisers (and investment advisers that are required to be registered) to adopt written BCPs and annually assess the adequacy of those BCPs.[7]

Throughout the Proposing Release, the SEC reiterated that an investment adviser's fiduciary obligation under the Advisers Act includes protecting client interests from being placed at risk as a result of the investment adviser's inability to provide advisory services.[8] In 2004, when jointly adopting Rule 206(4)-7 under the Advisers Act and Rule 38a-1 under the Investment Company Act of 1940, as amended (1940 Act) (which required registered investment advisers and registered investment companies, respectively, to adopt written compliance policies and procedures and annual testing), the SEC stated that it expected an investment adviser's policies and procedures to address BCPs to the extent relevant to the investment adviser's business; however, the SEC did not identify the components that it felt were critical to such policies and procedures.[9]

Additionally, as a result of Hurricane Sandy, which in October 2012 significantly impacted the Northeastern US (where there is a concentration of financial services firms), the SEC issued a Risk Alert in 2013 identifying BCP weaknesses it had observed and encouraged investment advisers to review their BCPs.[10] In the Proposing Release, the SEC noted that as a result of that review, its examination staff also observed a wide range of specificity in the BCPs of advisers. However, prior to the Proposing Release, the SEC had not created an express requirement for an investment adviser to have a BCP, nor had it previously conveyed the amount of detail and specificity regarding BCPs as is set forth in the Proposed Rule.[11]

Requirements of a BCP under the Proposed Rule

Consistent with the SEC's approach under Rule 206(4)-7, an investment adviser's BCP should be "reasonably designed" to address the operational and other risks related to a significant disruption in the adviser's operations. In other words, investment advisers would be able to tailor the detail of each component of their BCPs based on the complexity of their business operations and the risks attendant to their particular business models and activities. Under the Proposed Rule, however, a BCP would be required to include policies and procedures addressing the following five key components:

1. **Maintenance of critical operations and systems, and protection, backup, and recovery of data.** Under the Proposed Rule, a BCP generally would be required to identify and prioritize an investment adviser's critical functions, operations, and systems and to consider alternatives and redundancies that would allow the adviser to continue operations in the event of a significant business disruption. An adviser's data protection, backup, and

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[6] *See* Proposing Release at pg. 19 (discussing the Report on the financial crisis of 2008. *See* Financial Crisis Inquiry Commission, Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States (Jan. 2011) at 22-23.

[7] The SEC noted that many firms already have instituted a broad range of BCPs and some are well-equipped to handle many of the issues raised in the Proposing Release. Such firms may only need to visit their existing infrastructure and ensure that it complies with the Rule, if adopted.

[8] *See, e.g.,* Proposing Release at pgs. 9, 15, and 23 (discussing SEC's 2003 release that required registered investment advisers and registered funds to adopt compliance programs).

[9] *See* Compliance Programs of Investment Companies and Investment Advisers, Advisers Act Rel. No. 2204, Investment Company Act Rel. No. 26,299 (Dec. 17, 2003) at n. 22 and accompanying text.

[10] *See* National Exam Program Risk Alert, SEC Examinations of Business Continuity Plans of Certain Advisers Following Operational Disruptions Caused by Weather-Related Events Last Year (Aug. 27, 2013).

[11] In December 2014, the Financial Stability Oversight Council (FSOC) requested information about asset manager transition plans. *See* Notice Seeking Comment on Asset Management Products and Activities, Financial Stability Oversight Council (Dec. 24, 2014); see also Update on Review of Asset Management Products and Activities, Financial Stability Oversight Council (Apr. 18, 2016). It is worth mentioning that the SEC states throughout the Proposing Release that it thoroughly considered comment letters received by the FSOC from several industry participants when drafting the Proposed Rule.

recovery process would have to address the maintenance of both hard copy and "soft copy" electronic books and records, as appropriate. Investment advisers would be required to ensure that they have an inventory of key documents (e.g., organizational documents, contracts, policies, and procedures), including the location and description of the items, as well as a list of the investment adviser's service provider relationships that are necessary to maintaining operations. Investment advisers also would have to identify key personnel and make arrangements for temporary or permanent loss of such personnel. Investment advisers also would need to consider and address, as relevant, the operational and other risks related to cyberattacks.[12]

2. **Prearranged alternate physical locations of the investment adviser's office and employees.** Advisers would have to identify a prearranged alternate physical location for its offices and/or employees. Specifically, the BCP would have to consider the geographic diversity of the investment adviser's offices or remote sites and employees, as well as access to the systems, technology, and resources necessary to continue operations at different locations in the event of a disruption.

3. **Communication plans for clients, employees, service providers, and regulators.** An investment adviser's BCP generally would be required to cover, among other things, the methods, systems, backup systems, and protocols that will be used for communications; how employees are informed of a significant business disruption; how employees should communicate during such a disruption; and contingency arrangements communicating who would be responsible for taking on other responsibilities in the event of loss of key personnel.

   In addition, BCPs generally would have to address employee training designed to ensure that, in the event of a significant business disruption, employees understand their specific roles and responsibilities and are able to carry out the investment adviser's BCP and continue the firm's operations. BCPs also would need to include the process by which the investment adviser would have prompt access to client records that include the name and relevant contact and account information for each client as well as investors in private funds sponsored by the investment adviser. Investment advisers generally would have to consider means for notifying its service providers of a significant business disruption of the investment adviser, how the investment adviser would be notified of a significant business disruption at a service provider, and how the entities would communicate with one another and clients or investors during such a disruption. The SEC also noted that the BCP would be required to include the contact information for relevant regulators and to identify the personnel at the adviser responsible for notifying such regulators of a significant business disruption.

4. **Identification and assessment of critical third-party service providers to address how the investment adviser will manage the loss of a critical service.** Under the Proposed Rule, BCPs would have to identify critical functions and services provided by the investment adviser to its clients, and third-party vendors supporting or conducting critical functions or services for the investment adviser and/or on the investment adviser's behalf. Critical service providers would generally include those providing services related to portfolio management, the custody of client assets, trade execution and related processing, pricing, client servicing and/or recordkeeping, and financial and regulatory reporting. According to the Proposing Release, once an investment adviser identifies its critical service providers, it would need to review and assess how these service providers plan to maintain business continuity when faced with significant business disruptions and consider how this planning will affect the investment adviser's operations.

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[12] The SEC and its examination staff have been particularly interested in cybersecurity issues as of late. *See* Cybersecurity Guidance, IM Guidance Update (Apr. 2015). Morgan Lewis has prepared materials regarding the SEC activity in this area. *See* our May 2016 article on Cybersecurity Concerns for ERISA Fiduciaries, September 2015 LawFlash on SEC and DOJ Hacking Prosecutions and February 2015 LawFlash on SEC and FINRA Cybersecurity Materials.

5. **A plan of transition in the event the investment adviser is winding down or is unable to continue providing advisory services.** In addition to planning for disaster recovery, the SEC added a requirement for BCPs to also address business transition planning. The SEC stated in the Proposing Release that BCPs generally would have to address and include (i) policies and procedures intended to safeguard, transfer, and/or distribute client assets during transition; (ii) policies and procedures facilitating the prompt generation of any client-specific information necessary to transition each client account; (iii) information regarding the corporate governance structure of the investment adviser; (iv) the identification of any material financial resources available to the investment adviser; and (v) an assessment of the applicable law and contractual obligations governing the investment adviser and its clients (including pooled investment vehicles) implicated by the investment adviser's transition.

Other Requirements of the Proposed Rule

The Proposed Rule also would require investment advisers to review the adequacy and effectiveness of their BCPs—at least annually. The review generally would have to consider any changes to the investment adviser's products, services, operations, critical third-party service providers, structure, business activities, client types, location(s), and any regulatory changes that might suggest a need to revise the BCP.

Additionally, the SEC proposed amendments to Rule 204-2 under the Advisers Act that would require investment advisers to make and keep copies of all written BCPs that are or were in effect at any time during the last five years, as well as any records documenting the investment adviser's annual review of its BCP.

Comments on the Proposed Rule and the Proposing Release are due by September 6, 2016.

IM GUIDANCE

Alongside the Proposed Rule, the SEC staff issued related guidance addressing BCPs for registered investment companies, including the oversight of the operational capabilities of key fund service providers.

In the Guidance, the SEC staff noted that business continuity planning has been a focus of the asset management industry since September 11, 2001, with additional attention focused on the issue after Hurricanes Katrina and Sandy. The SEC staff also highlighted a system malfunction in August 2015 that prevented a fund custodian and administrator from calculating accurate net asset values for hundreds of mutual funds and exchange-traded funds (ETFs) for several days. Although the staff acknowledged that it would be impossible for a fund complex to anticipate every potential business continuity event, it indicated that all of these events underscore the importance for funds to have robust business continuity policies and procedures in place that include oversight of third-party service providers.

Fund Compliance

The staff indicated that funds should consider how to mitigate risk exposure resulting from disruptions in services that could affect a fund's ability to continue operations. The staff believes that a fund's existing policies and procedures regarding business continuity planning should be tailored to the particular business of the fund. The staff also indicated that funds should consider conducting "thorough initial and ongoing due diligence" in connection with third parties that provide investment advisory, underwriting, administrative, custody, transfer agency, pricing and valuation, and auditing services, including with respect to the business continuity and disaster recovery planning of such service providers. It is also worth noting that the staff indicated that funds using a "turnkey" platform (where administrative and other back-office services are provided as a packaged solution to the fund sponsor) should consider the business continuity planning of their turnkey service provider or third-party fund administrator.

Notable Practices

The Guidance also lists six notable practices related to BCPs that the staff has observed at various fund complexes:

1. **Comprehensiveness of BCPs.** BCPs typically cover the facilities, technology/systems, employees, and activities conducted by a fund's investment adviser and any of its affiliated entities, as well as dependencies on critical services provided by other third-party service providers.
2. **Broad Involvement in BCPs.** BCPs typically involve a broad cross-section of employees from key functional areas, including senior management, information technology and security, operations, human resources, communications, legal and compliance, and risk management.
3. **Role of Compliance.** A fund's Chief Compliance Officer (CCO) and/or the CCO of other entities in the fund complex typically are involved in the oversight of third-party service providers, which often includes both initial and ongoing due diligence of the third parties, including with respect to their business continuity planning. The staff noted that fund complexes will often require some combination of materials from service providers, such as presentations, onsite visits, responses to questionnaires, independent control reports (such as SSAE 16 reports), written summaries of policies and procedures, and review of financial condition, insurance arrangements, and indemnification provisions.
4. **Involvement of the Fund Board.** The staff observed that fund boards are typically provided, on an annual basis, with presentations on business continuity planning, which often includes the CCO. The staff noted that these presentations typically coincide with either the fund adviser's annual contract renewal process in accordance with Section 15(c) of the 1940 Act, or the CCO's annual report to the board as required by Rule 38a-1 under the 1940 Act.
5. **BCP Testing.** In most instances, fund complexes will perform some sort of BCP testing, at least annually, the results of which may be shared with the board.
6. **Outages.** Business continuity outages, including those incurred by the fund complex or a critical third-party service provider, are monitored by the CCO and other pertinent staff, and reported to the fund board as warranted.

Additional Considerations

The Guidance also recommends that a fund's BCP should take into account the role of critical third-party service providers and should consider certain "lessons learned" from past events, including by doing the following:

- Examine critical service providers' backup processes and redundancies, the robustness of the providers' contingency plans, including reliance on other critical service providers, and how these providers intend to maintain operations during disruptive events. Fund BCPs should address the risk that service providers will suffer a significant business disruption and should also consider potential ways to respond to certain scenarios.
- Consider how to best monitor whether a critical service provider has experienced a significant disruption (such as a cybersecurity breach or other continuity event) that could impair the service provider's ability to provide uninterrupted services. Fund BCPs should also contemplate the potential impacts that such events may have on fund operations and investors and cover the internal and external communication protocols in connection with such events. The Guidance suggests that procedures for external communications should contemplate communications with the affected service provider and other service providers, intermediaries, fund shareholders, regulators, and the press, as warranted.
- Consider how various critical service providers' BCPs relate to one another. In this category, the Guidance notes the example of a third-party service provider that calculates the fund's daily net asset value and suggests that the fund complex should be familiar with such service

provider's back-ups and redundancies, and also contemplate steps to mitigate shareholder risk in the event of a disruption at such service provider.

- Plan for disruption from all critical service providers and how to manage business continuity risk under a variety of different scenarios, including both internal and external scenarios.

The Guidance suggests that fund boards should discuss the steps being taken to mitigate business disruption risk and the robustness of their business continuity planning with the adviser and other service providers.

IMPLICATIONS FOR ASSET MANAGERS

Leveraging Existing Resources

Many asset managers should be able to leverage existing compliance infrastructures to comply with the Proposed Rule (if adopted) and the Guidance (to the extent they manage registered funds). As noted in the Proposing Release and the Guidance, the SEC staff has observed that most firms already have some form of business continuity planning in place. Firms that are dually registered as broker-dealers will also likely be able to leverage their existing continuity planning structures required under FINRA Rule 4370 (which requires FINRA member firms to create and maintain a written BCP that identifies procedures for emergencies or significant business disruptions).[13] Similarly, asset managers affiliated with a bank may be able to leverage the "living will" requirement imposed on their bank affiliates.[14] Such advisers may also want to consider consulting with or leveraging personnel who worked on implementing their broker-dealer's or bank's business continuity planning initiatives. The SEC may also want to consider exempting from the Proposed Rule advisers that are dual-registrants or otherwise subject to a substantially similar regulatory framework.

Planning for "Acts of God"

The Proposed Rule seems to rest on the proposition that an adviser's fiduciary obligation to its clients includes a requirement to protect client interests from being placed at risk as a result of the adviser's inability to provide advisory services.[15] In support of this position, however, the SEC cites only to a brief statement in a footnote to the adopting release of Rule 206(4)-7, which itself states only that it is the SEC's belief that business continuity planning is required under an investment adviser's fiduciary duty, without any further citation to case law or legislative history supporting this belief.[16] Advisers traditionally have not been viewed as responsible for losses caused by acts beyond their reasonable control (i.e., force majeure events or "Acts of God"). However, the tenor throughout the Proposing Release implies that an adviser *could* be liable for client losses resulting from "Act of God" events—which by their very nature are impossible to predict in terms of time and magnitude—if the adviser fails to adopt sufficient procedures, the sufficiency of which will be evaluated in hindsight. The SEC may instead want to consider a disclosure-based approach whereby advisers would be required to consider reasonably foreseeable disruptive events and include meaningful risk disclosure in their firm brochures or in a standalone

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[13] *See* FINRA Rule 4370, Business Continuity Plans and Emergency Contact Information; *see also* Contact Information, FINRA Regulatory Notice 07-42 (Sep. 2007); Business Continuity Plans, NASD Notice to Members 04-37 (May 2004).

[14] *See* Proposing Release at n.40 (citing Section 165(d) of Dodd-Frank Act and discussing FDIC and Federal Reserve rules).

[15] *See* Proposing Release at 43,532 ("Because an adviser's fiduciary duty obligates it to take steps to protect client interests from being placed at risk as a result of the adviser's inability to provide advisory services, clients are entitled to assume that advisers have taken the steps necessary to protect those interests in times of stress, whether that stress is specific to the adviser or the result of broader market and industry events. We believe it would be fraudulent and deceptive 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 these services.").

[16] *See* Compliance Programs of Investment Companies and Investment Advisers, Investment Advisers Act Rel. No. 2204, Investment Company Act Rel. No. 26,299 (Dec. 17, 2003) at n. 22 ("We believe that an adviser's fiduciary obligation to its clients includes the obligation to take steps to protect the clients' interests from being placed at risk as a result of the adviser's inability to provide advisory services after, for example, a natural disaster or, in the case of some smaller firms, the death of the owner or key personnel. The clients of an adviser that is engaged in the active management of their assets would ordinarily be placed at risk if the adviser ceased operations.").

supplement for advisers that are not required to distribute a brochure.[17] Finally, to avoid a "chilling effect" that prevents individuals from joining or remaining in the compliance industry, the SEC may want to consider building into any final rule a safe harbor from individual liability.[18]

Implications of a "Fraud" Rule

Because the Proposed Rule would be promulgated under Section 206(4) of the Advisers Act, it would itself be an antifraud provision. As such, violations of the Proposed Rule would be violations of the antifraud provisions of the federal securities laws, which would implicate a number of collateral issues, such as contractual representations made to counterparties. Like Rule 206(4)-7, the SEC would be able to bring an enforcement action for non-substantive violations of the Proposed Rule (if adopted) without any required showing of any actual client harm. Similarly, although the Proposed Rule does include a "reasonably designed" standard similar to that of Rule 206(4)-7, in practice the SEC staff has applied Rule 206(4)-7 much more expansively than one might have expected based on the Rule's original proposing and adopting releases (i.e., the releases discuss broad areas of focus, but many SEC enforcement cases have focused on a very narrow, singular issue).

Assessing Current Structures

In light of the Proposing Release, advisers may want to conduct an inventory of how their existing BCPs apply to their various product offerings, engage key personnel (including investors and personnel at third-party service providers), and intersect with the business continuity planning efforts of key third-party service providers. Advisers should also evaluate the business continuity planning implications for structures in which they are deemed to have custody of client assets because a related person maintains client funds or securities. Asset managers may want to consider whether it would be worthwhile to submit a comment letter to the SEC and its staff in an effort to inform the rulemaking process.

In light of the Guidance, fund sponsors should be prepared to address additional inquiries from fund boards regarding the current business continuity planning procedures and whether any enhancements should be made to them. Funds should consider comparing their current BCP frameworks to the notable practices outlined by the SEC staff in the Guidance and, if any gaps exist, consider whether any additional procedures would be appropriate given the business of the particular fund complex and its interaction with and reliance upon third-party service providers. Given the staff's emphasis on learning from past lessons and its reference to the 2015 NAV-calculating error, fund complexes should evaluate whether their current BCPs provide sufficient coverage if a similar event were to occur, because the Guidance effectively puts the industry on notice that this is the kind of event that funds should consider when planning for contingencies.

Advisers may want to re-evaluate the results of their most recent BCP testing in the wake of the Proposed Rule and the Guidance set forth in the Proposing Release. Advisers may also wish to consider assessing the robustness of their annual testing processes to evaluate whether the testing provides an accurate proxy for an actual disruption event. In this vein, firms may want to consider whether a surprise test of certain elements of their BCPs would provide a more meaningful result than a predetermined test. In addition, advisers should assess whether their BCPs and annual testing procedures contemplate a sufficiently broad universe of potential disruption events.

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[17] It is worth noting that that although Rule 206(4)-7 under the Advisers Act and Rule 38a-1 under the Investment Company Act were developed and adopted in tandem, here the SEC has determined it necessary to codify business continuity planning requirements under only the Advisers Act. It is unclear why the staff took the approach of issuing the Guidance regarding Rule 38a-1 instead of a rule proposal, although it could be the fact that all registered investment companies will be indirectly covered by the Proposed Rule because their advisers are required to be registered.

[18] *See e.g.*, Rule 1001(b)(4) under Regulation Systems Compliance and Integrity (Reg SCI), which includes a safe harbor from liability for individuals.

Application to Small or Specialized Advisers

Although the Proposing Release discusses whether the Proposed Rule should apply differently to small advisers, there seems to be relatively little consideration given as to whether certain types of advisers should be excluded entirely. The SEC may want to consider limiting the Proposed Rule so that it applies only to systemically important investment advisers, with investment discretion and a certain minimum amount of client assets under management, that are not already subject to a similar regulatory requirement. Advisers that do not have investment discretion over client accounts or that do not provide "continuous and regular supervisory or management services" to clients do not appear to represent the types of risks that the SEC is seeking to protect against, and therefore should not be subject to the Proposed Rule. In the adopting release of Rule 206(4)-7, which the SEC cites throughout the Proposing Release, the SEC seemed to imply that the risk of an adviser ceasing operations would be more harmful to clients who rely on their adviser for "active management of their assets."[19] The Proposed Rule should also apply to a lesser degree to advisers with investment discretion but very low levels of assets (i.e., less than $150 million). Similarly, advisers that are dually registered as broker-dealers or that are already required to be wrapped into the "living will" requirements applicable to banking entities should not be subjected to a second—potentially inconsistent—regulatory requirement that polices the same conduct.

Multinational Managers

Asset managers that do business in multiple jurisdictions in which they are subject to business continuity planning and related compliance requirements[20] would have to assess if the Proposed Rule (if adopted) would require them to modify their existing framework, or whether it could just be formalized to comply with the SEC rule.[21]

Providing More Information to the SEC

It is worth noting that in the Proposing Release, the SEC requested comment as to whether advisers should be required to file their BCPs with the SEC and/or report disruption events to the SEC when they occur. If the SEC were to adopt these aspects in a final rule, advisers would want to carefully consider whether any proprietary or confidential client information is implicated. How the SEC and its staff would use such information—including whether there would be enforcement implications—would also be an open issue.

Oversight of Vendors

The Proposed Rule and the Guidance also continue a recent regulatory trend that focuses on the oversight of third parties and, in the context of funds, the role that the board plays in overseeing third-party service providers.[22] As a result, firms should consider whether their due diligence processes are robust enough, including the frequency with which ongoing due diligence is conducted, whether service providers are visited on site (and, if so, how frequently), and what other information is requested and obtained from third-party service providers.

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[19] *See* Compliance Programs of Investment Companies and Investment Advisers, *supra* note 16, at n. 22

[20] *See e.g.,* Monetary Authority of Singapore: Business Continuity Management Guidelines (June 2003) and Further Guidance on Business Continuity Management (January 2006) (outlining BCP principles and measures for financial institutions); s*ee also*, Bank of Japan: Business Continuity Planning at Financial Institutions (July 2003) (containing guidelines and action plans with respect to BCPs for financial institutions); Financial Conduct Authority Handbook (UK), SYSC 3.2.19 and 13.8 (requiring financial firms to put in place appropriate arrangements that will allow them to function in the event of an unforeseen interruption).

[21] In the Proposing Release, the SEC acknowledged that as of January 4, 2016, 1,051 SEC-registered investment advisers had registered in at least one foreign jurisdiction, representing a total of 2,279 foreign registrations. The SEC also noted that as of the same date, 780 foreign investment advisers were registered with the SEC.

[22] *See e.g.*, Third-Party Service Providers, FINRA Regulatory Notice 11-14 (Mar. 2011).

Implications for Current Corporate Transactions

Finally, although we suspect this would only be relevant for a small minority of firms in the market, given the regulatory attention now being paid to this issue, firms seeking to acquire a financial services company may want to consider evaluating the BCP of the target company, and firms seeking to be acquired or engaged in a business combination should consider whether their BCP is sufficiently robust to withstand scrutiny during the due diligence process associated with the transaction.

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