



Risk Management Update June 2013

DISASTER RECOVERY AND BUSINESS CONTINUITY PLANS: IS YOUR FIRM PREPARED FOR DISASTER?

Your firm's main office is located in Kansas. A major tornado tears through the area, devastating the office. What is your firm's protocol in the event of such a disaster?

The Securities and Exchange Commission ("SEC") and the Financial Regulatory Authority ("FINRA") mandates that investment advisers and broker-dealers take necessary steps to protect their clients' interests from being placed at risk if the adviser cannot provide services due to unanticipated events, such as natural disasters, business interruptions, incapacitation or death of key personnel, etc. Pursuant to Rule 206(4)-7 of the Investment Advisers Act of 1940 and FINRA Rule 4370, a business continuity plan ("BCP") for emergency preparedness and significant business disruptions must be included as part of a firm's compliance policies. During a regulatory examination, the SEC and FINRA will thoroughly review such plans. In addition, annually firms should test and assess the efficacy and functionality of its BCP to ensure that the enterprise and its employees are prepared.

This month's Risk Management Update outlines the importance for investment advisers and broker-dealers to have an effective BCP by developing safeguarding protocols, using internal controls and maintaining a forward-looking approach towards disaster preparedness and disclosures to clients.

Critical Elements of a Business Continuity Plan

There are several components to an effective BCP, which includes considerations for technology controls, communications and reporting. To begin the process, firms should assess what existing internal controls and safeguards they have, if any, in the following areas in the case of a disaster:

1. Data back-up and recovery efforts (both in hard copy and electronic format)
2. Identification of mission critical systems
3. Financial and operational controls
4. Alternate methods of communications between customers and the member
5. Alternate methods of communications between the member and its employees
6. Alternate physical location(s) for employees
7. Assessment of critical business constituent, bank and counter-party impact
8. Knowledge of regulatory reporting requirements
9. Methods for communications with regulators; and
10. Ensuring that customers have prompt access to their funds and securities.

Formulating Your BCP

In formulating a BCP, the firm must consider its clients' needs should a business interruption occur. For example, decide how you will communicate with clients to address their questions and to assist them with their requests for transactions or access to their assets and funds. Consider formulating a simulated disaster or business interruption scenario, such as a pandemic, and discuss internally how you may be able to best address each of these events.

Once this is complete, you are ready to start formulating the plan. The following information may help serve as a “checklist” for you to use and compare with against your own BCP to help ensure that you have addressed and/or considered various substantive areas.¹ The contents of a BCP do not have to be limited to just this information; a BCP should be customized and tailored to fit your firm’s business practice.

- **Emergency Contact** - Identify at least one individual, who should be either a member of senior management or a registered principal of the firm to serve as your emergency contact.
- **Firm Policy** – Outline your firm’s policy on how the organization will respond to a significant business disruption or disaster, including your firm’s communications and technology methods it may employ to enable clients to reach critical firm members to assist with addressing questions and accessing their funds and securities. Consider various scenarios such as:
 - Internal disruptions – such as a power failure
 - External disruptions – such as a terrorist attack, flood, hurricane, etc.

Dependent upon the model of your firm, either a member of the senior management team or a registered principal should be designated as the responsible party for approving the plan and overseeing the annual testing and review of the plan. The policy also should define where the plan is maintained and how employees and clients of the firm may obtain a copy of the BCP.

- **Business Description** – State the type(s) of business that your firm conducts and address how the BCP takes this into consideration within the plan. For example, if your firm does not perform any type of clearing function for itself or others and/or does not serve as a custodian, then you should provide the contact information as well as any alternate contact information for the clearing firm or custodian broker-dealer within the BCP.²
- **Office Locations** – List the locations of all of your offices, and define which mission critical operations take place at each location.
- **Alternate Physical Location(s) of Employees** – Discuss what, if any, alternative location the firm’s staff may use in the event of a significant business disruption (including home offices, branch offices, or other locations out of state).
- **Customers’ Access to Funds and Securities** - State whether or not your firm has custody of client funds or securities, and explain how you may assist your clients in accessing such funds or securities in the event of an SBD. Provide the names of the entities at which such funds and securities are held and your firm’s ability to grant customer access to funds and securities; (as applicable, consider the Securities Investor Protection Corporation (“SIPC”) regulations on the disbursement of funds and securities).
- **Data Back-Up and Recovery** - Identify the location of your firm’s primary books and records, as well as the location of its electronic records, including any alternative locations, such as offsite storage facilities. The following is a sample format you may wish to use:
 - **Hard Copy Records** – *Example:* “the firm maintains our primary hard copy books and records at [address]. [Name, title, phone number] is responsible for the maintenance of these books and records.”
 - **Electronic Records** – *Example:* “the firm backs-up its electronic records daily and keeps a copy at [location].”

¹ For more information and sample templates for business continuity plans, please visit <http://www.finra.org/Industry/Issues/BusinessContinuity/index.htm>.

² For more information and examples, please visit http://www.finra.org/web/idcplg?IdcService=GET_FILE&dDocName=p011163&RevisionSelectionMethod=LatestReleased&Rendition=primary&allowInterrupt=1.

- **Financial and Operational Assessments** – Memorialize your firm’s procedures to identify changes in its operational, financial and credit risk exposures in the event of a significant business disruption.
- **Mission Critical Systems** – Describe your firm’s protocols for taking orders, entering orders, executing orders and any other services provided to the customer, and explain how you will handle these operations in the event of a business interruption or disaster.
- **Alternate Communications** – Explain the alternate means of communication between the firm and its customers, employees and regulators. For example, “in the event of a disaster, where the firm traditionally communicates with a party by email and if the internet is not available, we will either call or text the client to notify them of our alternative communication mode to follow up with any questions.”
- **Critical Business Constituents, Banks and Counter-parties** – Describe your firm’s procedures to identify and assess the impact a business disruption may have on its relationship with counter-parties, and mitigation thereof.
- **Regulatory Reporting** – Explain how your firm will file regulatory reports in the event of a disaster or business interruption.
- **Disclosure of BCP** – For broker-dealers, state how you will distribute and disclose your BCP to the firm’s clients.
- **Updates and Annual Review** – State how and when the organization may test and update the plan, and if using an outside resource, who.

Conclusion

Once your BCP is established and internal controls effectuated, the firm should perform forensic testing on a periodic basis to help identify any potential vulnerabilities, which should be promptly corrected. The results of the tests should be documented, along with any corrective actions taken and maintained as part of the firm’s required books and records. The firm also should provide periodic training to all employees on how to prepare for and what to do in the event of a disaster. The firm should communicate to every employee the importance of understanding of the firm’s BCP, including their potential roles and responsibilities in carrying forth the plan and escalation processes to senior management if there are any potential concerns.

For more information, or to learn about how CCLS may be of assistance, please do not hesitate to contact us at (619) 278-0020.

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