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SEC Proposes Rule Requiring Investment Advisers To Adopt Business Continuity and Transition Plans

On June 28, the Securities and Exchange Commission (SEC) proposed a new rule, Rule 206(4)-4 (the “Proposed Rule”) under the Investment Advisers Act of 1940 (the “Advisers Act”), that would make it unlawful for an SEC-registered investment adviser (RIA) to provide investment advice unless the RIA adopts and implements a written business continuity and transition plan (BCTP). The Proposed Rule is designed to ensure that each RIA has a plan in place to address operational and other risks related to a significant disruption in the adviser’s operations in order to minimize client and investor harm.

While the SEC recognizes that many RIAs may already have business continuity plans in place as part of the policies and procedures in their compliance manuals, it has been the staff’s experience that BCTPs are not consistently comprehensive. For example, some BCTPs may address transition procedures while others may not. As a result, the SEC includes in the Proposed Rule specified components of an effective BCTP in an effort to facilitate the adoption and implementation of uniformly robust BCTPs for all RIAs.

Under the Proposed Rule, an RIA’s BCTP would be required to be maintained in writing and to include policies and procedures designed to address at least the following elements in the event of a disaster or other material disruption of business activities:

- maintenance of critical operations and systems;
- protection, backup and recovery of data;
- pre-arranged alternative physical location(s) of the RIA’s office(s) and employees;
- preservation of ongoing communications with clients, service providers and regulators;
- identification and assessment of third-party services critical to the operations of the RIA; and
- possession of a transition plan that accounts for the possible winding down of the RIA’s business or the transition of the RIA’s business to others in the event the RIA is unable to continue providing advisory services.

With respect to transition planning, the Proposed Rule would require the BCTP to include at least the following:

- policies and procedures intended to safeguard, transfer and/or distribute client assets during transition;
- policies and procedures in order to facilitate the prompt generation of any client-specific information necessary to transition each client account;
- information regarding the RIA’s corporate governance structure;
- the identification of any material financial resources available to the RIA; and

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- an assessment of the applicable law and contractual obligations governing the RIA and its clients, including pooled investment vehicles, that would be affected by the RIA's transition.

While each BCTP must address the above components, the SEC recognizes that operations vary significantly among RIAs. Therefore, the Proposed Rule permits RIAs to tailor their BCTPs based upon the complexity of their business and the risks related to each RIA's particular business model and activities.

The Proposed Rule also requires that each written BCTP be reviewed annually, although there are no proposed requirements regarding how this must be accomplished other than requiring documentation of the review. In addition, the SEC has proposed amendments to Rule 204-2 under the Advisers Act to require RIAs to make and keep copies of all written BCTPs that are in effect or were in effect at any time during the last five years, as well as any records documenting the RIA's annual review of its BCTP.

The Proposed Rule included a cost-benefit analysis that estimated "that SEC registered advisers may spend between approximately \$11,000 and \$1.3 million in additional, initial costs to upgrade systems and processes to comply with the Proposed Rule depending on the complexity of their operations and the current state of their systems and processes." (Proposing Release at 66-67.) Additionally, the SEC estimated "that an SEC-registered adviser would incur ongoing annual costs associated with the Proposed Rule that would range from \$7,500 to \$375,000." (Proposing Release at 68.) These cost estimates seem low and, in any event, compliance with the Proposed Rule potentially will impose significant additional costs on all registered investment advisers.

The comment period for the Proposed Rule and rule amendment will end on September 6, 2016.

At the same time that Rule 206(4)-4 was proposed, the SEC's Division of Investment Management issued a Guidance Update "Business Continuity Planning for Registered Investment Companies," available [here](#). The Guidance recommends procedures both for mutual fund complexes themselves and for third-party service providers to mutual funds.

Particularly noteworthy in the Guidance is the express designation to the Chief Compliance Officer of responsibilities for implementing, testing and reporting on the adequacy of the firm's BCTP. This is very different than what the SEC has proposed for investment advisers under the Proposed Rule.

Also noteworthy is the emphasis on the need for the mutual fund to independently test and evaluate the BCTPs of its independent third-party service providers, rather than simply relying on representations by the third-party providers regarding their BCTPs.

The Guidance is effective immediately.

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