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September 6, 2016

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

RE: Proposed Rule Amendments: Adviser Business Continuity and Transition Plans
Act of 1940
SEC File Number S7-13-16
Release No. IA-4439

Dear Mr. Fields:

This comment letter is submitted on behalf of National Regulatory Services ("NRS"), the nation's leading compliance consulting and registration firm founded in Lakeville, CT in 1983. NRS provides compliance and consulting services, compliance technology solutions, national conferences, seminars and the NRS Certified Compliance Professional certificate program to approximately 6,000 investment advisers, ranging from small state registered advisers to some of the largest global investment management complexes and private fund managers as well as other financial firms, including broker dealers and investment companies. NRS is a division of Accuity, the leading provider of global payment routing data, AML screening software, and services that allow organizations, across multiple industries, to maximize efficiency and facilitate compliance of their transactions. For more than 150 years, Accuity has provided its worldwide clients, including banks, corporations and government organizations located in over 150 countries, with solutions and services packaged in multiple formats to serve their diverse needs.

Advisers Act Rule 206(4)-4 (the "Rule"), as proposed in IA Release IA-4439 (the "Release"), seeks to require investment advisers that are registered or required to be registered with the Securities and Exchange Commission (the "Commission") to adopt and implement written business continuity and transition plans that are reasonably designed to address certain operational and other risks related to a significant business disruption in the investment advisers' operations. The Rule would require that these plans be risk-based and include certain minimum specified components and

procedures. NRS regards the proposed Rule as another important step in the Commission's continued efforts to protect U.S. markets and investors and includes the additional advantage of safeguarding investment advisers. NRS commends the Division of Investment Management for undertaking to strengthen adviser controls in this area and to provide relevant guidance and requirements, as applicable.

The significance of prudent risk-based controls reasonably designed to ensure that a firm is prepared for potential business disruptions and to ensure that an adviser's clients are protected from adverse consequences of such disruptions cannot be overemphasized. As the Commission has acknowledged in the Release, many investment advisers have already taken steps to mitigate the risks of business disruption through the adoption of a risk-based disaster recovery and business continuity plans among other prudent controls. Nevertheless, and consistent with the experience of Commission staff, NRS consultants too have noted wide disparity among the business continuity plans and related controls adopted by advisers and the adequacy of such plans to address the firm's inherent operational and other risks associated with a material service disruption. In general, therefore, and with the specific reservations and suggestions discussed below, NRS supports the Commission's proposal.

1. *Scope and Applicability of Rule*: As business entities dependent on technology, the Internet, human capital and experience as well as third party service providers to varying degrees, NRS holds that most SEC registered investment advisers possess operational risks. These risks will evolve over time as technology develops, new services or products are adopted, new systems are added, staff retire, leave the industry or move to other firms, and the methods employed by cybercriminals continue to shift. As fiduciaries, therefore, all SEC registered investment advisers should be required to periodically assess these risks and to mitigate them in the best interests of their clients through the adoption of reasonably designed Business Continuity and Transition Plans ("Plans").

   In its request for comment, the Release queries whether the Rule should be applicable to all SEC-registered advisers or if the Commission should identify a subset of advisers that will be subject to its provisions. The Release offers "large advisers with assets under management over a specific threshold" as an example of a possible subset. NRS does *not* believe that the applicability of Rule 206(4)-4 should be limited to a subset of advisers. As indicated, NRS considers that most investment advisers suffer operational risks. These risks also place those advisers' clients in jeopardy. Smaller advisers have limited resources to implement a Plan despite the fact that they and their clients may be at greater risk than larger firms from significant business disruptions if they should fail to adopt controls reasonably designed to safeguard the firm and its clients. For example, a single-person-adviser has no partner or protégé that can step-in to continue the management of client portfolios or necessarily notify clients of the death or incapacitation of the firm's sole owner and employee.

2. *Approach to Rule*: NRS also backs the approach taken by the Commission in proposed Rule 206(4)-4. We find that setting forth certain minimum components for a Plan while also articulating a clear expectation that firms will assess risk and adopt additional provisions to mitigate those risks, as appropriate, has proven effective in the approach taken by the Commission to Rule 206(4)-7. Unlike proposed Rule 206(4)-4, Rule 206(4)-7 does not, itself, specify particular content required in an adviser's written policies and procedures. However, the adopting release did specify certain minimum compliance areas that the Commission expected firms to address, as applicable, through the adoption of appropriate written policies and procedures. Moreover, the adopting release to Rule 206(4)-7 further articulated the Commission's expectation that advisers will identify conflicts and other compliance factors creating risk exposure for the firm and its clients in light of the firm's particular operations, and then design policies and procedures that address those risks.

   NRS believes that this approach has allowed advisers greater flexibility to design tailored and, in theory, more effective, compliance programs while at the same time providing firms with guidance and minimum expected standards. A similar framework for Rule 206(4)-4, as set forth in the Proposal, will result in more adequate and effective Plans than a more prescribed approach would do.

   To facilitate compliance, NRS recommends that the Commission also develop and provide to the industry a model Plan with sample provisions addressing the Rule's specific requirements, while including a clear disclaimer that the model is for illustrative purposes and assistance in preparing a Plan that will meet the minimum requirements of the Rule and is not intended to circumvent the important processes of assessing risk and tailoring a Plan accordingly.

3. *Clarification Requested*: Rule 206(4)-4, as proposed, would require that SEC-registered investment advisers have a "prearranged alternate physical location of the adviser's office(s)." NRS urges the Commission to clarify, in the Rule or the Rule's adopting release, that secure, remote access via a private internet connection by employees to firm systems or a back-up server, including cloud-based, maintained in a different geographical region than the adviser's principal office, would satisfy this requirement.

   Most SEC registered investment advisers are small businesses. According to the recently-released report, *2016 Evolution Revolution,* an annual study jointly issued by NRS and the Investment Adviser Association (IAA) and compiled from Form ADV, Part 1 data filed by all SEC-registered investment advisers as of April 8, 2016, the median number of employees for SEC-registered investment advisers is 9.[1] In fact, approximately 57% of SEC-registered investment advisers report 10 or fewer non-clerical employees and nearly 88% report employing 50 or fewer non-clerical individuals.[2] Using a different metric of business size,

[1] Investment Adviser Association & National Regulatory Services, "*2016 Evolution Revolution,*" 3, at https://www.investmentadviser.org/eweb/docs/Publications_News/EVREV/evolution_revolution_2016.pdf
[2] Ibid., 28.

approximately 72% of SEC-registered investment advisers report Regulatory Assets Under Management of less than $1 billion.[3]

NRS maintains that business size is a rough but reasonably reliable gauge of the total resources available for firm infrastructure, including operations and compliance. Consequently, NRS believes that requiring small advisers with only a single office to maintain an alternate physical location at which staff or even a limited number of select staff can gather to continue operations, including rent, redundant equipment, software licensing fees and facility maintenance, among other related costs, would be cost prohibitive and impose an undue burden. Moreover, following certain recent large-scale disasters impacting the U.S., some financial institutions discovered that previously-arranged, contingent back-up facilities were unavailable, notwithstanding prior agreements. While the space had been promised to multiple firms within a geographically dispersed area, the sheer scale of certain disruptive events imposed unexpected demands on some back-up sites, resulting in numerous firms requiring the same promised spaces at the same time.[4]

Remote access to firm systems and data, without a separate physical location (other than employees' homes) is a reasonable, low-cost and effective method of addressing the risk of the loss, damage or inaccessibility to an adviser's offices. Advancements in broadband technology and the advent of secure remote applications, for example, make operations from employees' homes safe and viable (and, NRS believes, is currently a common practice among SEC-registered advisers of various sizes). NRS urges the Commission, therefore, to acknowledge and to clarify in the Rule or the Rule's adopting release that this approach would satisfy the requirement for a "prearranged alternate physical location of the adviser's office(s)…" so long as the adviser (i) has implemented appropriate precautions to safeguard client data, (ii) that any remote back-up server be physically located a reasonable distance from the adviser's offices (e.g., on a different power grid), and (iii) that back-ups and connections be tested at least annually.

Another approach would be for the Commission to sanction partnership agreements among geographically-dispersed institutions (whether affiliated or unaffiliated). Such arrangements may permit the sharing of physical space on a temporary basis when one firm's primary office is impaired due to a disrupting event until the office can be restored or more permanent arrangements can be made, so long as proper protocols are adopted to safeguard the privacy of client nonpublic data for both firms.

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[3] Ibid., 12.

[4] Federal Financial Institutions Examination Council & Conference of State Bank Supervisors. "*Lessons Learned from Hurricane Katrina: Preparing Your Institution for a Catastrophic Event*," June 15, 2006, at https://www.ffiec.gov/pdf/katrina_lessons.pdf

4. *Disclosure of Plans to Clients*: NRS does *not* support any requirement that firms disclose their Plans to clients or prospective clients in full, nor do we support a requirement that they offer or provide a list of incidents in which the Plan was put into effect. Plans often include proprietary information as well as schematics or other details regarding systems and back-ups, safeguards and methods for accessing data, among other things. The disclosure of this information may place firms and clients/investors at greater risk for cybercrime. Further, Plans may be put into effect for any number of reasons, some of which do not pose a threat to clients or the security of their information or accounts. In fact, these incidents may be indicative of highly effective protocols and firm culture. Requiring disclosure of each occurrence in which the Plan's provisions were activated may lower client/investor confidence unnecessarily, undermine the client-adviser relationship or cause firms to be more reluctant to put their Plans into effect when appropriate. NRS believes that clients and investors desiring more detailed information regarding their adviser's Plans or incidents will request this information. Market forces can compel advisers to make such disclosure should demand be sufficient. In the absence of such demand, the Rule should not mandate it.

   As an alternative to requiring full disclosure of an adviser's Plan, NRS proposes that advisers be obliged to provide a summary of the Plan's principal components to its clients and to attest to the periodic testing of the same. Such disclosures may be made within the firm's Form ADV, Part 2A or in a separate annual notice.

5. *Consideration of the Components of Other Rules and Guidance*: NRS advocates the approach taken by the Commodity Futures Trading Commission ("CFTC") in 17 CFR 23.603(g) and recommends that the Commission adopt a similar requirement in Rule 206(4)-4. The CFTC requires that mandatory business continuity and disaster recovery plans be audited at least once every three years by a qualified third party service. NRS believes that periodic review of an adviser's Plan by a qualified third party will better ensure the adequacy and effectiveness of the Plan and aid firm management in determining whether its provisions have kept pace with regulatory expectations and interpretations, techniques employed by cybercriminals and advances in technology. A mandate that an unbiased expert, free of internal conflicts or pressures, evaluate the firm's controls with reasonably regular frequency will further protect clients and investors and strengthen client/investor confidence in the controls adopted by their advisers. The scope and cost of these reviews would be scaled to the size and complexity of the adviser's operations and control environment including a document only review option for the smallest and least complex advisers. NRS recommends that the Commission promulgate objective qualifications and/or expertise for such auditors that would be acceptable to the Commission and require that the selected third party auditor be independent of the adviser and its related persons and is otherwise free of conflicts that might bias its evaluation.

6. *Review, Testing and Report*: Rule 206(4)-4, as proposed, would require that an SEC-registered investment adviser review the adequacy of its Plan and the effectiveness of its implementation at least annually. NRS urges the Commission to clarify, in the Rule or the Rule's adopting release, its expectations with respect to these requisite reviews. For example, an annual reassessment of operational risks conducted in conjunction with a gap analysis to determine whether those risks have been mitigated through appropriate controls will be insufficient to assess the effectiveness of the Plan, as would a textual review to determine whether the Plan addresses each of the components and procedural requirements of Rule 206(4)-4, as adopted. NRS believes that the results of testing conducted to assess the effectiveness of controls must play a critical role in fulfilling this mandate. However, full scale tests of all essential components of many Plans on an annual basis would be cost prohibitive. As such, NRS requests that the Commission adopt an explicit requirement that certain critical components of the Plan, as identified from the adviser's own assessment of risk, be tested as part of the annual review efforts. An adviser's goal should be that all Plan components deemed reasonably necessary to recover operations following a significant business disruption be tested over the course of several annual reviews, rather than to either (i) seek to conduct full scale tests of all Plan components annually or (ii) to re-test the same components year after year while other critical aspects of the Plan remain ignored.

   Finally, NRS recommends that the Commission clearly state in any final rule whether it expects a written report be prepared documenting the mandatory annual review of the Plan. Not only will this make it easier for advisers to adhere to the Commission's expectations, it will also clearly establish those expectations prior to any regulatory examinations that occur up-to and following the first year anniversary of the Rule's compliance date.

If we may assist further or provide additional information or background on our comments, please let us know. We at NRS would certainly look forward to assisting the Commission in this very important area affecting the entire industry.

Sincerely,

John Gebauer

President