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August 23, 2016

Mr. Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549

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

Dear Mr. Fields:

The Investment Company Institute[1] appreciates the opportunity to comment on the Securities and Exchange Commission proposal that would require SEC-registered investment advisers to adopt business continuity and transition plans and review them annually.[2] We generally support such a regulatory initiative, particularly (i) a principles-based design, which would permit advisers to tailor their plans to the risks associated with their particular operations, and (ii) an emphasis on advisers' obligation to mitigate (rather than eliminate) risks of disruptions in their operations.

The business continuity plans (BCPs) of fund advisers and fund complexes[3] have developed over time in response to their experience with emergencies, their shared commitment to providing quality services to fund shareholders, and the SEC's regulatory efforts. While fund advisers and registered fund complexes clearly take seriously their BCP obligations and have robust plans in place, we appreciate that a regulatory initiative on this topic could foster incremental improvement across the

[1] The Investment Company Institute (ICI) is a leading, global association of regulated funds, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI's U.S. fund members manage total assets of $17.9 trillion and serve more than 90 million U.S. shareholders.

[2] *Adviser Business Continuity and Transition Plans,* SEC Release No. IA-4439, 81 Fed. Reg. 43530 (July 5, 2016)(the "Release"), available at www.gpo.gov/fdsys/pkg/FR-2016-07-05/pdf/2016-15675.pdf.

[3] We use the term "adviser" throughout to refer to an investment adviser registered with the SEC. Our comments focus on the proposal from the perspective of advisers to registered funds, and we express no views on the proposal's merits as they relate to advisers' non-fund clients. We use the term "fund complex" or "registered fund complex" throughout to refer to registered funds, their advisers, and other affiliated service providers that have BCP obligations.

industry.[4] With respect to transition planning, as the SEC recognizes, advisers routinely exit the market and are able to transfer client accounts without significantly impacting clients or the financial markets. Nonetheless, it may be modestly beneficial to require advisers to conduct some advance planning that could facilitate a transition if the need for one arises.

We have virtually no comments or concerns with the substance of proposed rule text. Notwithstanding this, we strongly recommend that the SEC issue guidance under Rule 206(4)-7 under the Investment Advisers Act of 1940 instead adopting this new rule,[5] because (i) the release adopting Rule 206(4)-7 first articulated, and provided a sound basis for, BCP requirements, (ii) the adoption of a new rule could create confusion about whether advisers have distinct BCP-related obligations under Rule 206(4)-7 and Rule 206(4)-4, and would very likely lead to enforcement actions that treat the same conduct as violating two distinct rules, and (iii) fund advisers would be able to navigate their BCP obligations more easily.[6]

We set forth below our concerns about certain statements in the Release. In each case we recommend that the SEC take a more measured approach to better reflect the industry's current operations or practical capabilities. We strongly object to one of the Release's sentences in particular, which seems to indicate that BCP- or transition planning-related violations (as determined by the SEC) would constitute *per se* fraud or deceit. We recommend, in the strongest terms, that the SEC clarify in any final release that these violations, in and of themselves, do not constitute fraud or deceit.

We also respond to certain questions that the Release poses. Overall, our responses indicate support for the SEC's decisions in setting the scope of this proposal. In addition, we request confirmation of our understanding of one aspect of the proposal's potential implications for advisers currently subject to separate business continuity and/or transition planning requirements.

Subject to our comments below, we believe the SEC would be well-positioned to issue final guidance on business continuity and transition planning. We first describe the registered fund industry's BCP efforts to date. We then provide more detailed comments on the proposal.

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[4] *See* Release at 43547 (noting that some advisers may already have robust business continuity and transition plans in place that are consistent with the proposed requirements, and that the proposal's incremental benefits to advisers' clients will vary depending on the strength of operational controls currently in place).

[5] Where we express support for the proposed rule text in this letter, it is intended as support for the *substance* of the rule text, rather than support for the adoption of a new rule. Given our preference for guidance, we frame our recommendations throughout this letter as relating to any final SEC-issued guidance. This could be accomplished through publication of a final Commission release.

[6] If the Commission adopts a new rule, fund advisers would need to follow the Rule 206(4)-7 adopting release together with Rule 206(4)-4 and its adopting release. Fund advisers also would need to consider existing, and possibly future, guidance from the SEC staff. *See infra*, notes 15 and 16.

I. The Registered Fund Industry's Business Continuity Planning Efforts to Date

Registered fund complexes have long appreciated the importance of BCP and have dedicated substantial resources to it. Over the past several decades, the fund industry has confronted and worked through a variety of emergencies that have either caused financial *markets* to close (*e.g.*, Hurricane Sandy in October 2012, which caused the New York Stock Exchange to close)[7] or caused a *fund complex's office* to close (*e.g.*, the San Francisco earthquake in October 1989).[8] These kinds of emergencies may cause power outages or interruptions to postal services, disrupt transportation, and/or impact critical fund operations.

To mitigate the risks to shareholders from such events, funds and their key service providers (including advisers) have robust plans and strategies in place to facilitate the continuation or resumption of business operations in the event of an emergency, regardless of the cause. These efforts took on increased urgency following the September 11, 2001 terrorist attacks. Since then, the nature and scope of BCPs have changed significantly, and fund complexes and their critical service providers have become more resilient to unexpected business interruptions.[9] Registered fund complexes and their key service providers coordinate closely with other market participants, regulators, exchanges, and offices of emergency management in response to emergencies.[10] These joint efforts have focused on seeking business continuance or resumption of normal operations, without adverse impact to investors or the financial markets.

As part of their BCPs, registered fund complexes commonly identify and prioritize the functions, technology, and personnel critical for maintaining business operations.[11] Fund complexes

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[7] Other examples include the 1963 assassination of President Kennedy, the 1994 assassination of a Mexican presidential candidate, and blackouts in New York City in 1977 and 1990.

[8] Other examples include the major power outages in Houston caused by Hurricane Ike in 2008 and the devastation in the Gulf Coast area caused by Hurricane Katrina in 2005.

[9] Two developments in particular help explain the reasons for the change. First, technology and processing improvements now make it possible for certain activities (*e.g.*, movement of data files between funds and the intermediaries that sell fund shares, settlement of previously executed trades, management of account transfers) to continue during unscheduled market events. Second, it is not uncommon for larger fund complexes and their critical vendors to have multiple business continuity sites located in different regions of the country, something that was not as common prior to 9/11.

[10] A recent example arose from a temporary NYSE trading halt on July 8, 2015. During the halt, ICI staff communicated with SEC staff, NYSE staff, ICI members, and others. Following the halt, ICI coordinated with members and SEC staff and issued a memorandum to its members to assist them in evaluating fund policies, procedures, and disclosure in light of unanticipated events on trading venues (available at www.ici.org/continuity/guides/ci.memo29831.idc).

[11] Fund complexes use many business continuity guidelines as resources to ensure the availability of critical services. These resources include the Federal Financial Institutions Examination Council (FFIEC) Information Technology Examination Handbook, Business Continuity Planning booklet (ithandbook.ffiec.gov/it-booklets/business-continuity-planning.aspx),

and critical vendors test their BCPs on an ongoing basis, using a variety of approaches and scenarios that evolve as appropriate.[12] Registered fund complexes and fund boards also evaluate the BCP capabilities of the funds' key vendors, including advisers. This due diligence typically includes an assessment of vendors' ability to continue business operations in a variety of emergencies. Professionals with business continuity expertise and other key advisory personnel carry out this process. And in addition to the oversight that fund boards provide, other clients (particularly institutional clients) evaluate advisers' BCPs.[13] These external evaluations are indicative of the importance that clients place on BCPs, and reinforce their importance to advisers. Apart from the need to satisfy regulatory requirements, advisers' commitment to their BCPs is a critical expectation among advisers' institutional clients.

In addition to these strong internal motivations and market-based expectations, the SEC's regulation and oversight have aided in improving advisers' BCPs. While the SEC to date has not expressly articulated advisers' BCP obligations in a rule under the Advisers Act, it has indicated that an adviser's compliance policies and procedures should address BCPs to the extent that they are relevant to the adviser.[14] The SEC staff previously has examined fund complexes and their critical service

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and the SANS Institute (www.sans.org/reading-room/). Complexes often conduct a business impact analysis using a cross-functional team drawn from technology, business operations, and risk. An important part of this process is the identification and estimation, by business units and information technology staff, of proposed recovery time objectives (*i.e.*, the maximum tolerable length of time that a computer, system, network, or application can be unavailable after an emergency occurs) and recovery point objectives (*i.e.*, the age of the files that must be recovered from backup storage for normal operations to resume in the event of an emergency).

[12] Tests may include table top exercises with a small number of people, virtual tests with multiple departments, and, in some cases, complex "surprise" exercises involving actual first responders, actors simulating terrorists, and employees simulating injuries. These tests are repeated periodically so that employees are well-trained in a variety of emergency situations.

[13] Advisers often consider their complete BCPs confidential, and provide current and prospective clients with information that they believe is responsive to clients' evaluations without revealing sensitive information. *See infra*, Section II.E.

[14] *Compliance Programs of Investment Companies and Investment Advisers*, SEC Release No. IA-2204, 68 FR 74714, 74716 (Dec. 24, 2003) ("Compliance Rules Release"), available at www.sec.gov/rules/final/ia-2204.pdf. The Compliance Rules Release also made clear that Rule 38a-1 (the compliance program rule for registered funds) requires registered funds' or their advisers' policies and procedures to address the issues identified for advisers, including BCPs.

providers' BCPs and capabilities and has published its findings.[15] Most recently, the SEC staff provided guidance addressing business continuity risks for registered fund complexes.[16]

Finally, for many years ICI has served as a point of contact on these issues for regulators and others, and as a resource and forum for members and the industry broadly.[17] Senior technology representatives responsible for BCP at ICI member fund complexes meet periodically each year to exchange emergency event information, discuss challenges encountered, establish or improve industry recommended practices, and receive presentations from private BCP experts. Additionally, ICI has a separate Operations Response Task Force, comprised of fund and intermediary back office operations professionals, key service providers including the industry utility, the Depository Trust and Clearing Corporation (DTCC),[18] and industry business continuity experts, to facilitate and improve resilience between funds, intermediaries, and DTCC. This Task Force developed and reviews annually the Mutual Fund Operations Planning Guide for an Unexpected Market Close[19] to assist funds and

[15] For example, the SEC staff conducted targeted exams of approximately 40 advisers immediately after Hurricane Sandy in 2012. Its findings are available at www.sec.gov/about/offices/ocie/business-continuity-plans-risk-alert.pdf. Among other things, the SEC staff found that advisers generally had: (i) adopted and maintained written BCPs that were widely distributed within their businesses and operations; (ii) switched to back-up sites or systems in advance of trouble; (iii) implemented technology to allow employees to work from remote sites (including from home); (iv) communicated with employees before, during, and after the storm regarding such things as the status of the adviser's business, operations, and backup locations; and (v) conducted tests of their BCPs prior to the storms. *See also* SEC Compliance Alert (June 2007), available at www.sec.gov/about/offices/ocie/complialert.htm (examinations following Hurricane Katrina of advisers located in Louisiana and Mississippi found, among other things, that (i) on average, firms were able to resume trading and manage accounts within 32 hours of the hurricane, and to resume general operations within five days of the hurricane; (ii) most firms maintained communication with their clients via email and the firm's website; and (iii) none of the firms reported clients having difficulty accessing their funds or initiating transactions in the days and weeks following the hurricane).

[16] *Business Continuity Planning for Registered Investment Companies*, SEC Division of Investment Management Guidance Update (June 2016)(the "Guidance"), available at www.sec.gov/investment/im-guidance-2016-04.pdf. The Guidance discusses "a number of measures that the staff believes funds *should consider* as they evaluate the robustness of their fund complex's plan in order to mitigate business continuity risks for funds and investors." (emphasis added) Guidance at 1. Because these are staff—rather than Commission—views, we urge the SEC in any final guidance to explicitly direct SEC examiners to administer them as such.

[17] *Cf.* Joint Review of Business Continuity and Disaster Recovery of Firms by the SEC's National Examination Program, the Commodity Futures Trading Commission's Division of Swap Dealers and Intermediary Oversight and the Financial Industry Regulatory Authority on August 16, 2013, available at www.sec.gov/about/offices/ocie/jointobservations-bcps08072013.pdf. ("Firms are encouraged to participate in industry groups and task forces that may assist firms in strengthening their communication plans.")

[18] DTCC's Wealth Management Services provides automated trading, settlement and data exchange services for the mutual fund industry. Additional information is available at www.dtcc.com/wealth-management-services.

[19] The guide is available to ICI members.

intermediaries in preparing for processing challenges associated with an unplanned market closure.[20] The Task Force also facilitates industry planning and communication efforts in anticipation of potential disruptions[21] or during events.[22]

In sum, industry focus and regulatory oversight have created a sound baseline of BCP practices. To a large extent the proposed requirements would codify the key components of current industry practices.

II. Comments on the Proposed Rule and the Release Generally

This section briefly summarizes the proposal, provides general comments on the proposal's approach, and addresses separately the BCP and transition planning aspects of the proposed rule. It then responds to certain questions that the Release poses. Finally, it explains our concerns with the SEC's legal justification for the proposal.

A. Summary of the Proposal

Proposed Rule 206(4)-4 under the Advisers Act is designed to ensure that advisers have plans in place to address operational and other risks related to a significant disruption in their operations, in order to minimize client harm. The proposed rule would require an adviser to (i) adopt and implement written business continuity and transition plans addressing several components,[23] and (ii) review the

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[20] ICI's website also has a business continuity resource center that has proven valuable to members in past emergencies. It is available at www.ici.org/continuity.

[21] A recent example is the January 2015 "Snowmageddon" event that impacted the Northeast. The Task Force communicated events as they unfolded; contingency plans ultimately proved unnecessary because the markets were unaffected.

[22] Using standing procedures and technology, the Task Force can convene quickly to assist in planning for, or responding to, industry-wide disruptions.

[23] Specifically, these components would include: (i) maintenance of critical operations and systems, and the protection, backup, and recovery of data; (ii) pre-arranged alternate physical location(s) of the adviser's office(s) and/or employees; (iii) communications with clients, employees, service providers, and regulators; (iv) identification and assessment of critical third-party services; and (v) a transition plan that accounts for the possible winding down or transition of the adviser's business to others. This transition plan would include the following components: (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 of the adviser; (iv) identification of any material financial resources available to the adviser; and (v) 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.

adequacy and effectiveness of that plan at least annually. The proposal also includes related amendments to the recordkeeping rule for advisers.[24]

B. General Views on the Proposal's Approach

We generally support the proposed rule's substance. We appreciate that the SEC has not proposed a one-size-fits-all approach. Flexibility is critically important, because (i) BCPs in particular constantly evolve, and (ii) it is not possible to design one rule that fits the myriad of fund advisers (and certainly not one for all advisers generally). Thus, a uniform and prescriptive rule for advisers simply would not be workable. The Release usefully elaborates on these points, stating that:

> the business continuity and transition plan of a large adviser with multiple locations, offices, or business lines likely would differ significantly from that of a small adviser with a single office or only a few investment professionals and employees. … The complexity and risks associated with these diverse business models could be substantially different, and our proposed rule is designed to give advisers the flexibility to create business continuity and transition plans that accommodate such differences.[25]

Additionally, we were pleased to see the emphasis, in both the Release[26] and the Guidance,[27] on advisers' and fund complexes' obligations to *mitigate*, rather than eliminate, risks of operational disruptions. Accordingly, we urge the Commission to underscore this point in any final release, explicitly stating that it expects the staff to focus on whether the plans "are reasonably designed to address operational and other risks related to a significant disruption."[28] The Commission should express the same overarching principle with respect to the Guidance.[29]

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[24] The proposed amendments to Rule 204-2 under the Advisers Act would require an adviser to keep a copy of all written business continuity and transition plans that are in effect or were in effect at any time during the last five years, as well as any records documenting the adviser's annual review of its plan.

[25] Release at 43538.

[26] "While we recognize that an adviser may not be able to prevent significant business disruptions (*e.g.*, a natural disaster, terrorist attack, loss of service from a third-party), we believe robust planning for significant business disruptions can help to mitigate their effects and, in some cases, minimize the likelihood of their occurrence." *Id*. at 43534.

[27] "The staff recognizes that it is not possible for a fund or fund complex to anticipate or prevent every business continuity event." Guidance at 7.

[28] Proposed Rule 206(4)-4(b).

[29] Potentially broad and troubling language in the Guidance illustrates the importance of this point. For instance, it states, "The staff believes that fund complexes should consider how they can 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, the *potential impacts* such events *may* have on fund operations and investors, and the communication protocols and steps that *may* be necessary for the fund complex to successfully navigate such events." (emphasis added) Guidance at 5. If the point is simply to emphasize the need for a fund complex to monitor

Moreover, we strongly recommend that the SEC issue guidance under Rule 206(4)-7 addressing business continuity and transition plans in lieu of adopting the proposed rule. This is our strong preference for a number of reasons.[30] The Compliance Rules Release first articulated, and provided a sound basis for, BCP requirements.[31] In addition, adopting this new rule could create uncertainty about whether advisers have distinct BCP-related obligations under Rule 206(4)-7 and Rule 206(4)-4. Having dual sources for virtually the same obligations could very likely lead to enforcement actions that treat the same conduct as violating two distinct rules. Finally, fund advisers would be able to navigate their BCP obligations more easily if the SEC were to issue guidance under the existing compliance rule.[32]

If the SEC ultimately determines to adopt a new rule, at a minimum, we recommend that it also (i) clarify that compliance with the new rule would suffice for purposes of fulfilling any BCP-related obligations under Rule 206(4)-7, and (ii) stipulate that in those situations where an adviser violates the new rule, it will seek enforcement under the new rule only (unless there are separate and distinct grounds for finding a violation of the compliance rule).

C. ICI's Views on the Proposal's Treatment of Business Continuity Planning

We support, without modification, the substance of the BCP-related rule text, and address below specific points related to the application and interpretation of three of the rule's four components. Our comments relate to the appropriate considerations related to personnel under BCPs, maintaining inventories of "key documents," expectations regarding alternate physical locations, and assessments of vendor BCPs.

Personnel-related considerations should be flexible, and should not subsume succession planning as it is traditionally understood. The proposed rule would require advisers' plans to address "[m]aintenance of critical operations and systems, and the protection, backup, and recovery of data, including client records." In describing this provision, the Release mentions the need to identify key personnel and address their temporary or permanent loss. More specifically, it states that "an adviser's business continuity and transition plan generally should include short-term arrangements, such as

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the performance of critical service providers and consider generally how significant interruptions would affect the fund complex (and how it would respond), then the statement is reasonable. If the staff expects something more (*e.g.*, vendors reporting each cybersecurity breach, and fund complexes discerning each scenario that might impair their operations), then these regulatory expectations exceed what is reasonable or appropriate.

[30] Alternatively, the SEC could consider adopting the proposed rule's substance by amending Rule 206(4)-7 itself.

[31] *See infra*, Section II.F, for a discussion of the stark contrast in the SEC's legal rationales for Rule 206(4)-7 and proposed Rule 206(4)-4.

[32] *See supra*, note 6.

which specific individuals would satisfy the role(s) of key personnel when unavailable, and long-term arrangements regarding succession planning and how an adviser will replace key personnel."[33]

We generally agree with the importance of considering key personnel within BCPs. But we request clarification with respect to two aspects of the Release language highlighted in the paragraph above. First, we do not necessarily view this proposed requirement as an exercise in cataloguing names of key individuals and their backups. It is often appropriate to identify titles or departments (rather than individuals) as providing, supporting, or backing up critical functions, particularly in light of the personnel changes that advisers routinely experience. BCPs must identify and assign key responsibilities, but requiring too much specificity can impede BCP efforts (and require fairly frequent updates to BCPs). Therefore, we recommend that any final release make clear that firms have the flexibility to identify titles, departments, or key individuals, as appropriate.

Second, we view personnel considerations for BCP purposes as something distinct from "succession planning" as that term is commonly understood. Succession planning is often highly sensitive,[34] and any written plans are not broadly accessible within or outside most organizations. Moreover, succession planning often may involve certain personnel that are crucial to an adviser's success (*e.g.*, sales managers), but perhaps not to its ability to function day-to-day. Accordingly, the SEC should make clear that any final guidance does not subsume succession planning as it traditionally has been understood.

With respect to BCPs, advisers should focus on identifying personnel essential to maintaining operational continuity and ensuring sufficient backup for that purpose on a short- and intermediate-term basis. Other considerations (*e.g.*, long-term plans to replace permanently key personnel, or business ramifications of losing key personnel), important though they may be, should remain outside the scope of BCPs and are better treated as human resources and perhaps senior management functions.

Inventories of "key documents" should be high-level and focus on identifying locations. In connection with data backup and recovery, the Release states that plans "generally should include an inventory of key documents (*e.g.*, organizational documents, contracts, policies and procedures), including the location and description of the item … ."[35] We believe that any expectations in this regard should focus on identifying *categories* of key documents and their locations. For example, a fund adviser may have dozens of investment management agreements and amendments thereto with its fund clients alone, and trying to itemize this ever-changing list within the BCP would serve no useful purpose.

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[33] Release at 43539.

[34] This is so for both the adviser and the named individuals. In some cases, succession planning is a collaborative effort, with individuals sharing very sensitive information about their future plans (*e.g.*, when they plan to retire, and estate planning details). This would be seriously undermined if succession plans became part of more widely available BCPs.

[35] *Id*. at 43539.

Advisers' means of implementing the pre-arranged alternate physical location requirement will differ, and geographical diversity should be a consideration only. The proposed rule would require advisers' plans to address "[p]re-arranged alternate physical location(s) of the adviser's office(s) and/or employees." We understand this as permitting use of other existing (and operational) offices, employee residences, or *ad hoc* locations (*e.g.*, hotels), without requiring the procurement of a dedicated alternate site.[36] We request that the SEC confirm our understanding in any final release. The focus should be on whether an adviser has the requisite capability to continue servicing its clients—even if it cannot do so out of a particular location—and requiring the adviser to take steps within reason to achieve that outcome.

We also agree that advisers should *consider* geographic diversity, but the absence of this diversity should not be a *per se* violation of this provision.[37] This will be particularly important for smaller advisers, which may have only one office and a small number of employees who reside relatively close to that office. For these advisers, the appropriate and most feasible "pre-arranged alternate physical location(s)" may very well be employees' residences, assuming they have remote access. Indeed, this may be the only course of action in many situations (irrespective of an adviser's size), particularly if personnel are not able to leave their homes and safely travel to an alternate location.

Advisers' assessments of vendors' BCPs, and their ability to change vendors, are subject to practical limitations. The proposed rule would require advisers' plans to address "[i]dentification and assessment of third-party services critical to the operation of the adviser."[38] We support this

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[36] The Release supports this view, stating that "a smaller adviser with minimal employees may be able to function by enabling its employees to telework and access the adviser's systems remotely instead of requiring formal meeting space." *Id*. at n.127. More generally, the Release states, "We recognize that it may not be feasible or may be cost prohibitive for an adviser to retain backup service providers, vendors, and/or systems for all critical services." *Id*. at n.91.

[37] Similarly, we agree with the SEC's decision not to require that any alternate location(s) be a specified distance away from the adviser's primary location. *Id*. at n.80. Simplistic reliance on distance can be an imperfect proxy for risk mitigation, and advisers need flexibility in considering and using alternate locations.

[38] We assume that critical "third-party services" would be those provided by service providers unaffiliated with the adviser, because an adviser will already be familiar with an affiliate's BCP. The Guidance notes that BCPs typically cover the facilities, technology/systems, employees, and activities conducted by the adviser and any affiliated entities. Guidance at 4. The Guidance also draws a distinction between affiliates and third parties throughout, stating elsewhere that key business functions and related activities may be performed by an affiliate of the fund complex, a third-party service provider, or some combination thereof. Guidance at 5. Reading the term "third-party services" otherwise (*i.e.*, to include services provided by affiliates) in the proposed rule or the Guidance would create duplicative due diligence obligations for advisers with affiliates providing critical services. We request confirmation of this in any final release.

requirement.[39] Critical vendors themselves are often extensively regulated entities,[40] and advisers' assessments of critical vendors should include evaluation of their BCP capabilities, along with consideration of potential redundancies and alternatives.

We recommend that the SEC acknowledge in any final release the legitimacy of certain limits on advisers' oversight of vendors' BCPs and ability to change vendors. First, advisers generally do not receive and review third parties' complete BCPs. Advisers instead often receive and evaluate summaries of BCPs, which set forth general features and principles but (deliberately) omit specific information. The SEC states that "we understand that such [adviser BCP] information could be considered proprietary by some advisers and the public disclosure of business continuity and transition plans may make advisers more vulnerable to attacks from third parties, such as cybersecurity attacks that target the contingency plans laid out in an adviser's business continuity and transition plan."[41] The same holds true for advisers' vendors. Advisers find this and other related information useful in making assessments,[42] but an adviser's knowledge of a vendor's BCP cannot be expected to match that of its own BCP.

Second, while *consideration* of alternatives for critical services is a reasonable expectation, the SEC should acknowledge the practical limits on advisers' ability to *change* vendors, particularly in times of stress.[43] The Release correctly notes that retaining backup service providers, vendors, and/or systems may not be feasible or may be cost prohibitive.[44] Consequently, advisers in many cases will not have retained a backup vendor ready to assume responsibilities on short notice if the current vendor experiences a disruption. In addition, making a quick and seamless switch of vendors—whether or not

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[39] As discussed more generally above, the aim for this requirement should be the mitigation—rather than the elimination—of risks associated with critical vendor disruptions. *See supra*, Section II.B.

[40] *See, e.g.*, Letter to the Financial Stability Oversight Council from Paul Schott Stevens, President & CEO, ICI, dated March 25, 2015 ("2015 FSOC Comment Letter"), at 61 and 65, available at www.ici.org/pdf/15_ici_fsoc_ltr.pdf (noting, among other things, that (i) of the large banks that act as fund custodians, all are subject to extensive regulation and supervision by federal or state banking regulators, and most are subject to heightened regulation and supervision under Title I of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 and/or standards for global systemically important banks, and (ii) Depository Trust Company (DTC), the Fixed Income Clearing Corporation (FICC), and the National Securities Clearing Corporation (NSCC) (entities that provide centralized processing, clearing, and settlement services for regulated funds) are regulated as systemically important financial market utilities under Title VIII of the Dodd-Frank Act).

[41] Release at 43550.

[42] Advisers also may consider regulators' and other entities' independent assessments of these third parties' BCPs in evaluating their operations.

[43] Similarly, bringing functions "in-house" often will not be practicable, because advisers simply will not have the internal systems, resources, or expertise to do so. These limitations explain why advisers outsource certain functions in the first place.

[44] *Id.* at n.91.

the backup has been previously identified and/or retained—often may be impracticable for other reasons.[45] An adviser may be able to best protect client interests in the midst of a disruption by remaining with its vendor, closely monitoring the situation, and communicating to relevant parties (*e.g.*, clients and potentially the SEC) throughout.

With respect to vendor disruptions, advisers' most effective risk mitigant by far is to conduct due diligence of critical vendors' BCPs in advance of hiring them and periodic due diligence thereafter (prioritizing those critical vendors for subsequent reviews depending on their importance). Market incentives complement these efforts, because an adviser can choose not to hire (or ultimately take steps to replace) a vendor if it determines that the vendor is not committing sufficient resources to its BCP. In addition to this general need to meet client expectations, vendors understand that serious disruptions can harm their reputations and thus their financial and competitive standing, and thus have strong incentives to maintain robust BCPs.

D. ICI's Views on the Proposal's Treatment of Transition Planning

While transition planning as a formal explicit regulatory requirement would be new for most advisers,[46] neither transitions nor planning in connection with them (once they become more than hypothetical) are new to advisers. This sub-section explains why advisers' transitions are highly unlikely to present client protection or financial stability concerns. It then evaluates the proposed rule's transition planning requirements focusing on registered fund clients, and provides the basis for our general support for this part of the rule.

We addressed the topic of "resolution" of mutual funds and their advisers extensively in our 2015 FSOC Comment Letter.[47] We explained why mutual funds and their advisers do not experience disorderly failure and, as a related matter, why the resolution or liquidation of a mutual fund or its adviser, even in circumstances of financial market stress, is highly unlikely to present financial stability concerns. In doing so, we emphasized the following with respect to advisers:

- the agency nature of the asset management business (which means that fund advisers typically have small balance sheets with limited assets and liabilities);

[45] Generally speaking, vendor changes (*e.g.*, those involving custodians, fund accountants, or transfer agents) can be time-consuming and resource-intensive under the best of circumstances. When the current vendor is experiencing a disruption, this would heighten the difficulty involved in making any change.

[46] Advisers affiliated with certain financial companies have experience with analogous responsibilities under Section 165(d) of the Dodd-Frank Act, which requires certain financial companies to have plans for rapid and orderly resolution in the event of material financial distress or failure.

[47] 2015 FSOC Comment Letter at 72-82 and Appendix B.

- the existence of a variety of well-established exit strategies (*e.g.*, sales or mergers of the management business), even in periods of market stress;

- the provisions in the Investment Company Act of 1940 that require funds to maintain strict custody of fund assets, separate from the assets of the fund adviser, and to use an eligible custodian;

- fund boards' ability to transfer (or terminate) funds' advisory contracts, should circumstances warrant; and

- the high degree of competition in the fund industry, and advisers' strong desire and willingness to manage additional assets.[48]

We commend the Commission for determining that the rulemaking's primary objective is client protection.[49] The Release states, "In the normal course of business, it is our understanding that advisers routinely transition client accounts without a significant impact to themselves, their clients, or the financial markets."[50] It continues: "In addition, we are aware of instances of non-routine disruptions at large advisory businesses that have resulted in transitions to new advisers or new ownership without appearing to have a significant adverse impact on clients, fund investors, or the financial markets."[51] We fully agree with both statements.

Even by the SEC's account, there is precious little historical evidence of adviser transitions that have harmed clients. After offering its positive overall assessment of advisory transitions to date (quoted above), the Release cites several examples of more difficult or unusual transitions—two involving advisers and two involving funds—that presumably support the need for a formal transition planning requirement. In the Appendix to this letter, we briefly summarize each. In the case of the two adviser transitions, we demonstrate that the highly unusual circumstances notwithstanding, there is no evidence of the transitions themselves harming clients. With respect to the two fund events, we demonstrate why this new proposed rule for advisers almost certainly would not have altered favorably the experience of the funds or their investors.

In sum, neither an overall assessment of the asset management industry's experience with transitions, nor a careful examination of the four cases that the Release cites, demonstrates a compelling

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[48] We applaud the SEC for acknowledging several of these points in the Release.

[49] The Release states that an adviser could be impacted by broader market events, but offers no evidence or examples of the causality running the other way, *i.e.*, advisers' distress impacting the financial markets and overall economy.

[50] Release at 43535.

[51] *Id*. at 43535-43536. The Release cites as an example advisory firm Neuberger Berman being spun out of Lehman Brothers during the 2008 financial crisis into a private company. *Id*. at n.45.

purpose or need for extensive rulemaking in this area, either on client protection or systemic risk grounds. Nevertheless, it may prove modestly beneficial in certain circumstances to require advisers to evaluate the legal and operational implications of transitions in advance and to adopt plans that could facilitate their execution should the need arise. Because the proposed rule's requirements in this area, as we read them, are sensibly drawn, we generally support them, subject to the comments and concerns expressed below.

The aim should be to create plans that are general enough to be broadly useful, irrespective of the particular circumstances that may give rise to the transition. In doing so, an adviser could consolidate key objective information and identify processes that would be important in winding down its business. The expectation should *not* be to catalog every possible contingency that could lead to an adviser winding down its business, address all potential legal and operational implications associated with each, and set forth a corresponding plan—this would be impossible.[52] In other words, having a generally applicable "playbook" is a worthwhile aim; attempting to script a play (or series of plays) for every contingency in advance is not.

We see an adviser's obligations with respect to registered fund clients as being quite limited with respect to some of the proposed components. For instance, because the fund adviser does not maintain custody of fund assets, the first requirement ("[p]olicies and procedures intended to safeguard, transfer, and/or distribute client assets during transition") would appear to be much more germane for fund custodians than advisers. To be sure, fund advisers interact with and provide instructions to fund custodians, so we would expect an adviser's obligations to be limited to providing information necessary so that another entity (*e.g.*, a successor adviser) could step in and interact with the custodian as necessary and appropriate. Likewise, we see the second requirement ("[p]olicies and procedures facilitating the prompt generation of any client-specific information necessary to transition each client account") as largely being an exercise of indicating which fund service providers maintain key fund information (*e.g.*, the transfer agent generally maintains information about a fund's shareholders, and the custodian has detailed information about a fund's holdings), so that this "information puzzle" can be quickly assembled if an adviser is replaced. Final guidance along these lines would be quite beneficial to advisers trying to determine how to apply these new requirements across client types.

[52] In this regard, we are concerned with the Release's suggestion that a transition plan should include "the identity of affiliates (both foreign and domestic) whose dissolution or distress could lead to a change in or material impact to the adviser's business operations." *Id*. at 43542. We support the inclusion of objective information about an adviser's corporate governance structure in its transition plan. We also support requiring advisers to identify and assess services critical to their operations, as part of the BCP component. (Even if an affiliate were to experience a disruption or even exit its line of business, this may have no bearing on the adviser's ability to remain in business and effectively service its clients.) We do not support the inclusion of subjective risk assessments in a transition plan.

Satisfying some of these components might require different information depending on the type of client,[53] and advisers should be permitted to do so with respect to broad categories of clients (*e.g.*, "U.S. registered funds, private funds, separately managed accounts"). This certainly would be true of the fifth component (assessing the applicable law and contractual obligations governing the adviser and its clients). For instance, if an adviser manages a number of U.S. registered funds, we would expect the adviser's plan to address such funds collectively and to include the following kinds of information:

- A means of contacting fund boards,[54] and the funds' process for calling a special meeting and/or handling non-routine matters;

- A listing of the funds' key service providers, along with brief explanations of the services they provide (and the fund-related information they maintain) and their current contact information;

- General descriptions of the primary means of transitioning funds (*e.g.*, liquidations, reorganizations, or the termination of the adviser and the hiring of a new adviser), their basic legal requirements (*e.g.*, whether shareholder approval is needed), and the basic operational steps associated with each.

We would *not* expect the adviser to create a distinct "plan" for each fund, because (i) the adviser would not have unilateral authority to enact it (board, and in some cases, shareholder, approval would be needed)[55] and (ii) in any event the adviser would not be able to identify the best course of action until confronted with the particular set of facts and circumstances giving rise to, and present during the time of, the transition.

We are concerned with one element of the proposed rule text: identification of any material financial resources available to the adviser. We do not object to this requirement if it is limited to merely identifying *potential* material financial resources (*e.g.*, accessing lines of credit or obtaining capital from an owner or affiliate). If the SEC intends this obligation to go beyond this (*e.g.*, assessing the *availability* or *amounts* of these resources in stressed conditions), then we request that the SEC eliminate it, because it would be impossible for an adviser to know in advance how its balance sheet would look in ordinary or stressed conditions (or what those conditions might be); whether external sources of capital, liquidity, or funding would in fact be available in such varying conditions (and if so,

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[53] We believe that an adviser generally could satisfy the third and fourth elements (information regarding the corporate governance structure of the adviser and identification of any material financial resources available to the adviser) in a general manner, without specific reference to its client types.

[54] Fund boards will differ in how they prefer to be notified when called upon to consider non-routine matters.

[55] For instance, Section 15 of the Investment Company Act requires the written contract between the adviser and the fund to be approved by the board and shareholders. Section 205(a)(2) of the Advisers Act requires any investment advisory contract to prohibit an assignment of such contract without client consent.

how much); or what the precise resource need would be to fully effect a transition. Both for this element and transition planning generally, advisers should consider contingencies, but their plans should memorialize objective information that could be consulted or applied if the need arises.

We recommend that the Commission address each of the items above in any final release.

E. Responses to Specific Questions in the Release

Below we respond to certain questions that the Release poses. We also explain why a compliance period of at least one year is necessary for this proposal.

- ***Should the SEC adopt a more prescriptive rule that calls for a more specific transition plan similar to the "living wills" required by the Federal Reserve Board and the FDIC for large banks and systemically important non-bank entities?***

  For the reasons set forth above, we strongly support the SEC's decision to take a principles-based approach to this rulemaking. We appreciate the distinction that the Release draws between this SEC proposal and the Dodd-Frank Act's resolution plan or "living will" requirements applicable to certain bank holding companies and other financial companies. For the reasons that the Release provides (*e.g.*, advisers do not accept insured "deposits," do not have access to the Federal Reserve discount window, and do not use their own balance sheets when trading client assets), we agree that imposing a bank-like set of regulatory requirements on advisers would be inappropriate and unjustifiable. We would add that the high improbability of advisers' transitions presenting client protection or financial stability concerns does not occasion the sort of regulatory concerns (*i.e.*, risks to the financial system at large) that motivate the highly prescriptive approaches taken elsewhere.

- ***Should the SEC require advisers to provide disclosure to their clients about their business continuity and transition plans?***

  We strongly support the SEC's decision not to propose such a requirement. We agree with the SEC's assessment that such information could be considered proprietary, and the public disclosure of business continuity and transition plans may make advisers more vulnerable to attacks from third parties, such as cybersecurity attacks that target the contingency plans laid out in an adviser's business continuity and transition plan.[56] As part of their due diligence, clients (particularly institutional clients) often will request from advisers information about their BCPs, and advisers will provide information that they believe is responsive to the request without revealing confidential or otherwise sensitive information. Because (i) current practice affords clients the opportunity to receive BCP-related

[56] Release at 43550.

information from advisers, and (ii) each adviser must strike its own careful balance in this regard, we believe further requirements in this area would be unwise and potentially harmful to advisers.

- ***Should the SEC require advisers to report to the Commission, or disclose to their clients, incidents where they rely on their business continuity and transition plans?***

  We strongly support the SEC's decision not to propose such a requirement. If BCPs work as intended, advisers (or key vendors) will experience events that lead to the activation of their plans but not necessarily disruptions (*e.g.*, for certain advisers, the Baltimore riots of 2015). Moreover, not all disruptions affect clients (*e.g.*, because the disruption is short-lived, or redundancies work as expected). Requiring this type of reporting or disclosure risks stigmatizing the normal and healthy workings of BCPs, and could create disincentives for advisers to activate their BCPs. As a practical and legal[57] matter, both clients and the SEC will know if an adviser experiences a disruption that materially affects its business, or is transitioning out of the asset management business. Finally, the proposed rule would require annual reviews of plans, and these reviews (the documentation of which would be subject to the amended recordkeeping requirements) could account for these types of incidents.

- ***Should the SEC require advisers to file their business continuity and transition plans, or a summary thereof, with the Commission?***

  We strongly support the SEC's decision to exclude such a filing requirement from the proposal. The SEC would have full access to advisers' plans under the proposed amendments to the recordkeeping rule, providing it with sufficient information to oversee advisers. By contrast, a filing requirement would place all of this sensitive industry-wide information with a single entity, which could heighten advisers' BCP risks if this information were to be compromised.

- ***What, if any, implications will the proposed rule have for advisers that also are subject to other regulatory requirements as to business continuity and/or transition planning?***

  The Release states that advisers that are also registered as broker-dealers would have to comply with FINRA's rule as well as the proposed rule.[58] We believe that permitting advisers to adopt and implement a single plan that satisfies all legal requirements to the

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[57] Proposed Rule 206(4)-4(b)(2)(iii) would require advisers' plans to address "[c]ommunications with clients, employees, service providers, and regulators."

[58] Release at n.18.

> extent applicable (*e.g.*, those of the SEC and FINRA) should suffice, would be more cost-effective for those advisers already subject to separate business continuity and/or transition planning obligations, and would facilitate compliance with all applicable requirements. We request confirmation of this in any final release.

Finally, the Release does not specify a compliance date. We recommend that the SEC provide at least a one-year period from adoption of any final requirements for advisers to comply. This would provide a reasonable amount of time for advisers to evaluate their current practices in light of the new legal requirements, revise or create legally-compliant plans (or underlying policies and procedures), and adopt and implement those plans.

F. SEC's Legal Justification for This Rulemaking

The Release outlines the SEC's rulemaking authority under Section 206(4) of the Advisers Act, and then suggests that an adviser's fiduciary duty obligates it to take steps to protect client interests from being placed at risk if the adviser is unable to provide services. We agree that the loyalty and care expected of a fiduciary obligate it to take reasonable measures to maintain the continuity of its services to its clients. The Release, however, goes on to state:

> 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 those services.[59]

We strongly disagree with this statement, for which the Release provides no legal support.[60] We are concerned that the statement is vague and may lead to claims of fraud simply because an interruption of advisory services occurs. At its core, a BCP incorporates careful judgments regarding the potential business continuity risks to which the adviser and its clients are subject (including considerations of the magnitude and probability of those risks), balanced against the feasibility and costs of mitigating them. No matter how diligent an adviser has been in developing and administering its BCP, complete risk mitigation—for risks both foreseeable and unforeseeable—will be impossible to achieve.

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[59] *Id*. at 43532 (emphasis added).

[60] Prior SEC statements asserting that there are well known and clearly understood boundaries around what constitutes fraud under the Advisers Act evidence the lack of legal support for this proposition. In particular, the SEC has previously stated, "The legal authorities identifying the types of acts, practices, and courses of business that are fraudulent, deceptive, or manipulative under the federal securities laws are numerous, and we believe that the conduct prohibited by rule 206(4)-8 [*i.e.*, the rule prohibiting fraud by advisers to certain pooled investment vehicles] is sufficiently clear and well understood." *Prohibition of Fraud by Advisers to Certain Pooled Investment Vehicles*, SEC Release No. IA-2628 (Aug. 3, 2007), available at www.sec.gov/rules/final/2007/ia-2628.pdf.

In addition to being vague, this statement also reflects a legally overbroad conception of fraud and deceit, and threatens to capture conduct that is not in fact fraudulent or deceptive.[61] Advisers should not be exposed to fraud claims solely because the SEC, after the fact, deems that their "steps taken" proved to be inadequate.[62]

The SEC seeks to rely on Section 206(4) for this rulemaking. Indeed, this provision permits prophylactic rulemaking that makes unlawful certain acts or omissions that may not be inherently fraudulent and deceptive. Explicitly prophylactic rulemaking of this kind is preferable to what the SEC attempts to do in this proposal, because it acknowledges that certain forms of conduct may be problematic without stating that they are, in and of themselves, fraudulent and deceptive. Unfortunately, instead of making the case for the proposed rule as a reasonable exercise of its prophylactic rulemaking authority, the SEC has attempted to expand the definitions of "fraudulent and deceptive" beyond any recognized meaning.

The SEC's justification for this rule stands in stark contrast with its measured justification for BCPs in the Compliance Rules Release:

> 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.[63]

The implications from a vague and legally overbroad justification for Section 206 rulemaking are not academic. We are concerned that SEC examination and enforcement staff will use this Release

[61] There are generally six elements of common law fraud and deceit: there must be (1) a false representation of; (2) a material; (3) fact; (4) knowledge by the defendant of the falsity (*i.e.*, *scienter*), but stated nonetheless for the purpose of inducing the plaintiff to rely on it; (5) justifiable reliance by the plaintiff; and (6) damages suffered as a consequence. The enumeration of these elements in large measure carries over to the securities laws. *See* Loss, Seligman, and Paredes, Fundamentals of Securities Regulation at 1261 (Sixth Ed. 2011). *See also United States v. Elliott*, 62 F.3d 1304, 1312 (11th Cir. 1995), *amended per curiam*, 82 F.3d 989 (11th Cir.)(quoting S. Rep. No. 1760, 86th Cong., 2d Sess. (1960), which identified the elements of fraud and deceit that were acknowledged in adding Section 206(4) to the Advisers Act). We recognize that as the case law addressing fraud under the federal securities statutes (including the Advisers Act) has developed, claims of fraud need not include all of these elements. The less applicable those elements are to a particular course of conduct, however, the less compelling the argument for labelling such conduct as fraudulent or deceptive.

[62] A legitimate fraud claim conceivably could arise if, for example, an adviser intentionally and materially misrepresents to clients the features or scope of its BCP and related activities.

[63] Compliance Rules Release at n.22.

language as a license, or even an obligation, to cite advisers as deficient in examinations or to bring enforcement actions against them. If the SEC deems that an adviser has not taken sufficient steps with respect to its BCP and transitioning planning, and that this is *per se* fraudulent and deceptive, then presumably the Commission could bring actions against the adviser under Advisers Act provisions other than Section 206(4) (*e.g.*, Section 206(2)). By contrast, the SEC made clear in Compliance Rules Release that a failure to comply with the terms of Rule 206(4)-7 would result in a violation of Section 206(4); it did not go farther and state that such a compliance failure would constitute fraud and deceit.[64]

To remedy this serious misstep, we strongly recommend that the SEC clarify in any final release that independent claims of fraud and deceit (*i.e.*, those other than the more attenuated claims that may arise from violations of Section 206's prophylactic rules) require more than a technical determination from the SEC that an adviser's BCP and transition planning were insufficient. The SEC also should clarify that it does not follow automatically from a service disruption that the adviser (i) has committed fraud, (ii) has implemented a deficient BCP, or (iii) has not taken steps to protect client interests. Final guidance that makes these points would correct the Release's overreaching, place the content of this proposal on firmer footing, and be consistent with how the SEC framed advisers' BCP responsibilities in the Compliance Rules Release.

III. Comments on Proposed Amendments to Rule 204-2

The proposed amendments to Rule 204-2 would require an adviser to keep copies of all written business continuity and transition plans that are or were in effect at any time during the past five years, as well as any records documenting the adviser's annual review of its plan. At first blush, these proposed recordkeeping requirements seem reasonable. In practice, however, they could be quite difficult to implement and follow. The SEC appears to view BCPs in particular as relatively static plans memorialized on paper. BCPs, understood broadly, are often multi-part plans with highly detailed information, maintained electronically and subject to constant development. These changes can include personnel and organizational updates (*e.g.*, personnel turnover or opening or closing an office); changes in vendors (and vendors' personnel); adoption of new technology or outsourcing of certain functions; and responses to evolving risk assessments generally. Consequently, an adviser's BCP could have dozens of slightly differing iterations over the course of a five-year period. Maintaining each prior iteration would serve no obvious purpose, could be quite onerous, and could create internal confusion regarding which version of the plan is current.

A number of reasonable alternatives would provide the SEC with a complete picture of an adviser's current plan and its evolution in a more efficient and effective manner. Keeping a copy of the complete *current* plan, which the adviser could produce upon request, is a reasonable expectation, and

[64] *Id.* at n.11.

one we support. With respect to earlier plan changes, we would recommend that advisers keep copies of the complete plan as of one particular date each year for the past five years,[65] along with the complete current plan. Additionally, the proposal would require advisers to keep records documenting their annual reviews of their plans, which could note significant revisions to the plans over time. Taken together, these measures would adequately demonstrate how the plan had evolved over the previous five years.

* * *

We appreciate the opportunity to provide these comments on the proposal. If you have any questions regarding our comment letter or would like additional information, please feel free to contact me at (202) 326-5815; Dorothy Donohue, Deputy General Counsel, at (202) 218-3563; or Matthew Thornton, Assistant General Counsel, at (202) 371-5406.

Sincerely,

/s/ David W. Blass

David W. Blass
General Counsel

cc: The Honorable Mary Jo White
The Honorable Kara M. Stein
The Honorable Michael S. Piwowar

David W. Grim, Director
Diane C. Blizzard, Associate Director
Alpa Patel, Branch Chief
Division of Investment Management

[65] We strongly recommend having this five-year period commence as of the compliance date. Assuming a compliance date in 2018, advisers would have a full five years of plan-related records by 2023.

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Appendix: Summary of Transitions Cited in the Release

The following is a summary of the four transitions involving either advisers or funds that the Release cites and about which the SEC expresses some concern. We briefly summarize each. In the case of the two adviser transitions, we discuss why, the highly unusual circumstances notwithstanding, there is no evidence of the transitions themselves harming clients. With respect to the two fund events, we discuss why this new proposed rule affecting advisers almost certainly would not have altered favorably the experience of the funds or their investors.

1. F-Squared Investments, Inc.

F-Squared Investments, Inc. is an adviser that the SEC charged with advertising a materially inflated, and hypothetical and back-tested, performance track record for its investment strategy. Among other things, the December 2014 SEC settlement required F-Squared to pay $30 million in disgorgement and $5 million in civil penalties. In July 2015, F-Squared filed for bankruptcy.[1] That same day, an unaffiliated adviser agreed to acquire F-Squared's intellectual property, investment strategies, and investment management contracts;[2] the acquisition was completed in September 2015.[3]

This case demonstrates that even in the highly unusual event of a bankruptcy, an adviser can transfer its clients' accounts. Indeed, once an adviser is faced with the prospect, or is in the midst of, bankruptcy, it is very much in all parties' interest for the adviser to transition its clients as expeditiously as possible. Otherwise, the adviser continues to lose assets under

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[1] *See, e.g.,* Trevor Hunnicutt, *F-Squared Files for Bankruptcy*, Investment News (July 8, 2015), available at www.investmentnews.com/article/20150708/FREE/150709926/f-squared-files-for-bankruptcy (noting that after settling charges with the SEC, F-Squared's assets under management declined by nearly $8 billion for the year ended March 31, 2015, and then fell by nearly $6 billion more when Virtus Investment Partners Inc. terminated F-Squared as sub-adviser for five Virtus mutual funds).

[2] *See, e.g.*, PR Newswire, *Cedar Capital Subsidiary Broadmeadow Capital Agrees to Acquire Assets of F-Squared Investments* (July 8, 2015), available at www.prnewswire.com/news-releases/cedar-capital-subsidiary-broadmeadow-capital-agrees-to-acquire-assets-of-f-squared-investments-300110317.html.

[3] *See, e.g.*, PR Newswire, *Broadmeadow Capital Completes Acquisition of F-Squared Assets* (Sept. 23, 2015), available at http://www.prnewswire.com/news-releases/broadmeadow-capital-completes-acquisition-of-f-squared-assets-300147629.html.

management, and the collective value of its investment management contracts (a key source of value for any acquiring firm) declines.

2. Strong Capital Management, Inc.

The SEC brought an enforcement action related to mutual fund market timing against Strong and its founder in 2004. Among other things, the settlement required Strong to pay $40 million in disgorgement and $40 million in civil penalties, required the founder to pay $30 million in disgorgement and $30 million in civil penalties, and barred the founder from the industry.[4] From a transition planning perspective, the noteworthy takeaway is that six days after the SEC settlement, an unaffiliated financial services company agreed to acquire Strong's assets, facilitating the transition of Strong's clients to a new, healthier adviser.[5]

3. Primary Fund

The Primary Fund was a money market fund that "broke the dollar" in September 2008.[6] The Release notes in particular that the Primary Fund relied on an adviser's proprietary system for pricing fund shares that could not accommodate certain events, which impeded the handling of redemption requests. At that time, however, the money market fund industry typically did not have the operational capacity to process purchases and redemptions at prices other than a fund's stable net asset value ("NAV"). That is, fund and vendor systems, including the Primary Fund's proprietary system, often were programmed at a $1.00 NAV per share to process transactions. As a result of this limitation, Primary Fund share transactions thereafter were processed manually, which contributed to delays in meeting shareholder redemptions. The SEC has since addressed this issue through amendments to Rule 2a-7 under the Investment Company Act.[7] More importantly, had money market fund advisers been subject to the proposed transition

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[4] *See, e.g.*, Christine Dugas & Sandra Block Strong, *Strong Capital, Founder to Pay $140M in Settlement*, USA Today (May 20, 2004), available at usatoday30.usatoday.com/money/perfi/funds/2004-05-20-strong-settle_x.htm.

[5] *See, e.g.,* PR Newswire, *Wells Fargo Agrees to Acquire $34 Billion in Assets Under Management From Strong Financial Corporation* (May 26, 2004), available at www.prnewswire.com/news-releases/wells-fargo-agrees-to-acquire-34-billion-in-assets-under-management-from-strong-financial-corporation-74222912.html.

[6] Following the bankruptcy of Lehman Brothers on September 15, 2008, the Primary Fund (a series of The Reserve Fund), which held $785 million in Lehman commercial paper, began experiencing heavy redemptions. On September 16, 2008, the Primary Fund announced that it would break the dollar and re-price its securities at $0.97 per share.

[7] After the events of 2008, the SEC amended Rule 2a-7 to require that a fund (or its transfer agent) have the capacity to redeem and sell its securities at a price based on the fund's current NAV per share, including the capacity to sell and redeem shares at prices that do not correspond to the stable NAV or price per share. The 2010 amendment essentially requires that shareholder transactions be processed even under circumstances that require a fund to break a dollar. As a result of these regulatory changes, all money market funds must have the operational capacity to break the dollar and to continue to process shareholder transactions in an orderly manner. In 2014, the SEC further amended Rule 2a-7 to remove the valuation exemption that permitted institutional prime money market funds to maintain a stable NAV per share and require those funds to transact at a floating NAV.

planning requirements in 2008, there is little reason to believe that this particular fund share processing limitation would have been widely identified and remedied prior to September 2008.[8]

4. Long-Term Capital Portfolio, L.P.

Long-Term Capital Portfolio, L.P. was a private fund managed by Long-Term Capital Management, L.P. in the 1990s that nearly collapsed and required an extraordinary infusion of new equity from a consortium of the fund's primary counterparties and creditors to survive.[9] In analyzing the fund's portfolio, the Working Group Report noted that "the distinguishing features of the LTCM Fund were the scale of its activities, the large size of its positions in certain markets, and the extent of its leverage … ."[10]

It is important to note that this would not appear to qualify as a transition as the SEC uses the term, because both the adviser and fund operated for some time following the capital infusion. Further, given that the circumstances and events that gave rise to the consortium's agreement were highly idiosyncratic, it is difficult to see how a transition plan requirement for advisers would have achieved an appreciably better outcome for this private fund, its adviser, its investors, or its counterparties and creditors.

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[8] Registered investment companies are generally required to pay redemption proceeds within seven days of the redemption request under Section 22(e) of the Investment Company Act. This operational limitation existed alongside this more specific statutory requirement for funds, strongly suggesting that a more general transition planning rule affecting *advisers* almost certainly would not have produced a different outcome.

[9] *See generally Report of The President's Working Group on Financial Markets, Hedge Funds, Leverage, and the Lessons of Long-Term Capital Management* (Apr. 28, 1999)("Working Group Report"), available at www.treasury.gov/resource-center/fin-mkts/Documents/hedgfund.pdf.

[10] Working Group Report at 11.