

**National Examination Program, Risk Alert
August 27, 2013**

“The Securities and Exchange Commission’s Office of Compliance Inspections and Examinations (OCIE) today issued a Risk Alert on business continuity and disaster recovery planning for investment advisers. The alert was prompted by a review of responses to Hurricane Sandy, which caused widespread damage to Northeastern states and closed U.S. equity and options markets for two days in October 2012.”

Below is Focus 1’s summary of the Risk Alert.

Staff Observations:

A. Widespread Disruption

- ✓ General Observations – most advisers maintained a written Business Continuity Plan (“BCP”), distributed them annually to staff, and in some cases required employees to certify their receipt. The common goal was to derive multiple solutions to help ensure they could meet their fiduciary duty to clients.
- ✓ Weakness Noted – BCP’s did not adequately address and anticipate widespread events, which resulted in interruptions in key business operations and inconsistent communications with clients.
- ✓ Possible Future Considerations – develop policies and procedures to address and anticipate widespread events, including interruptions in key business operations and loss of key personnel.

B. Alternative Locations Considerations

- ✓ General Observations – advisers generally switched to back-up sites or systems, if needed, in advance of trouble rather than waiting for shutdown or imminent threat. Some advisers maintained critical business functions in more than one location in order to reduce potential disruption of operations by regional events.
- ✓ Weakness Noted – some advisers did not have geographically diverse office locations, even when they recognized that diversification would be appropriate.

- ✓ Possible Future Considerations – consider loss of electrical failure and loss of other utility services (including an internet connection), and consider other sites farther away from the main office, so as to not be affected by the same utility outages.

C. Vendor Relationship Considerations

- ✓ General Observations – some advisers required third party service providers to test their BCP annually and report results to the adviser.
- ✓ Weakness Noted – advisers had not evaluated the BCP's of their key service providers, which did or could have prevented the adviser from executing their own BCP. In some cases, advisers did not keep an updated list of vendors and their contacts.
- ✓ Possible Future Considerations – review the IT infrastructure of service providers to determine whether their location is within the same geographic area (same utility providers, etc.), and determine whether this would create any unforeseen operational challenges.

D. Telecommunication Services and Technology Considerations

- ✓ General Observations – advisers had generally implemented technology to allow employees to work from remote sites, which typically included from home. Some power systems were tied to generators or used back-up batteries to allow for power back-up, while others elevated certain equipment from the ground to mitigate damage from flooding and tested server connections through the use of wireless cards.
- ✓ Weakness Noted – some advisers did not engage service providers to ensure that back-up servers functioned properly. Rather, the advisers relied solely on self-maintenance, which led to more interruptions in their key business operations.
- ✓ Possible Future Considerations – obtain guaranteed redundancy from internet providers, and if not already doing so, explore the use of cloud computing in lieu of keeping back-up files and systems in adviser's primary location.

E. Communications Plans Considerations

- ✓ General Observations – advisers generally had good communications with their employees, before during and after an event, with regular communications with clients through the use of telephones, email, websites, etc.
- ✓ Weakness Noted – some advisers did not adequately plan how to contact and deploy employees during a crisis and inconsistently maintained communications with clients and employees. Some advisers had an

overall plan, but it did not identify which personnel should execute and implement the various parts of the plan.

- ✓ Possible Future Considerations – advisers are encouraged to communicate with their clients ahead of a major event (storm), to determine what their needs may be if an extended outage occurs, and if not already doing so, explore the use of cloud computing in lieu of keeping back-up files and systems in adviser’s primary location.

F. Review and Testing Considerations

- ✓ General Observations – advisers generally tested their plans annually and some tested additionally, in preparation of an event (storm).
- ✓ Weakness Noted – infrequent and inadequate testing of the BCP and instances of advisers not testing all critical business operations and systems.
- ✓ Possible Future Considerations – advisers should consider testing the operability of all critical systems under the BCP using various scenarios. Such testing may minimize disruptions to operations because critical weaknesses may be identified and resolved, and personnel may become more fluent with using key systems while in the BCP mode.

Conclusion:

The NEP staff’s observations and information in this Alert should assist advisers in further developing their BCP’s to better address potential issues around key personnel, critical business systems and service providers, and the need for frequent and adequate tests to ensure all potential risks are addressed.

The NEP encourages advisers to review their plans and consider their effectiveness in light of the observations and information in this Alert.

Please give us a call with any questions, or if you would like us to conduct a review of your current BCP.

Regards,

Focus 1 Associates LLC