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## BUSINESS CONTINUITY AND DISASTER RECOVERY

# Are You Prepared for OCIE's Sweep of Business Continuity Plans and Coronavirus Actions?

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As the coronavirus pandemic continues to disrupt the private funds industry, regulators are keeping a close eye on advisers' ability to weather the crisis. As part of that effort, the SEC's Office of Compliance Inspections and Examinations (OCIE) has sent targeted document requests to multiple fund managers centered on their business continuity plans (BCPs).

OCIE's document requests have, among other things, sought copies of advisers' BCPs and information about how they are being used during the pandemic, including preliminary assessments of weaknesses revealed to date. OCIE has also included questions about BCPs in ongoing routine examinations and phone interviews with advisers as the agency attempts to assess the effect of the pandemic on the industry.

To help fund managers prepare for the SEC sweep of BCPs, the Private Equity Law Report interviewed several attorneys and compliance consultants for their insights. In addition to examining the scope and nature of the SEC's efforts to date, this article includes a redacted OCIE [document request list](#) (OCIE Request List) received by a fund manager at the outset of the coronavirus pandemic. Fund managers should review the OCIE Request List to prepare for future potential SEC scrutiny of their BCPs.

See our three-part series on withstanding the coronavirus pandemic: "[Form ADV Filing Relief, Investor Communications and Liquidity Risks](#)" (Mar. 24, 2020); "[Key Person Clauses, Fundraising Disruptions and Deal Flow Issues](#)" (Mar. 31, 2020); and "[Business Continuity and Other Operational Risks](#)" (Apr. 7, 2020).

## Nature of the BCP Sweep

### Method Used by OCIE

OCIE sent out formal document requests focused on BCPs that were similar to the OCIE Request List in late-March 2020. The agency shifted course shortly thereafter, however, to phone calls or incorporating the questions into existing examinations, rather than proceeding with a full-on sweep. "The SEC is conscious of how it looks, and the regulator obviously does not want to be seen as trying to score 'gotcha' points on BCPs in the middle of a crisis," Goodwin Procter counsel David N. Solander noted.

The SEC has generally struck a sympathetic tone with its coronavirus-related actions, such as extending deadlines for certain filings and excusing advisers from requirements to conduct in-person meetings. "During phone calls with investment advisers, the SEC is taking a bit of a broader fact-finding approach,

instead of asking specifically, ‘What does your BCP say, and how closely are you following it?’” Solander explained. “Those calls have not been antagonistic at all.”

See “[Former OCIE Private Funds Examiner Forecasts Potential SEC Response to Fund Manager Efforts During the Coronavirus Pandemic](#)”(Apr. 14, 2020).

The SEC’s favorable tone may be attributable, at least in part, to its preliminary findings when inquiring about fund managers’ BCP practices, suggested Sadis & Goldberg partner Daniel G. Viola. As most fund managers test their BCPs annually, they have generally been able to take the move to remote work in stride, he observed. “The SEC is getting some comfort from its sweep exam that the industry’s history of BCP testing and good compliance controls has helped minimize the potential for a major negative impact due to the pandemic.”

## Potential Sweep Results

Multiple attorneys who represent fund managers emphasized that the SEC sweep of BCPs seems to be primarily intended to gauge market risks arising from the coronavirus pandemic, rather than policing deficiencies at individual investment advisers.

To that end, the SEC may follow up its initial fact-finding efforts with targeted exams or a published summary of its findings, suggested Promontory Financial Group director Sarah Curran. “In the past, OCIE has aggregated that type of data to better inform its ongoing regulatory approach, whether to initiate targeted examinations, inform Commission policy decisions or publish risk alerts,” she explained. “It’s my opinion that OCIE will really wait to conduct targeted BCP exams until after

the pandemic passes so as to not be an undue burden on registrants.”

OCIE’s findings may take the form of a risk alert, which would mirror its approach after Hurricane Sandy caused widespread damage to Northeastern states and closed U.S. equity and options markets for two days in October 2012. If OCIE publishes a risk alert, it will likely not be until several months after the crisis ends and regulators have had time to assess the full impact of the pandemic. For a frame of reference, the agency published its [risk alert](#) (Risk Alert) after Hurricane Sandy in August 2013, long after the storm hit the East Coast.

For more on the effect of Hurricane Sandy, see “[Roundtable Addresses Trends in Private Fund Operational Due Diligence, Fund Expenses, Administrator Shadowing, Business Continuity Planning and Cloud Computing](#)” (Apr. 25, 2013).

## Scope of OCIE’s Sweep

Based on its questions to investment advisers, the SEC appears concerned about weaknesses related to remote work, vendors and broader market impacts. The OCIE Request List emailed to a registrant in late-March 2020 requested, among other things:

- a copy of the firm’s BCP;
- any other compliance policies and procedures that address business continuity; and
- any policies, procedures, guidance or other information tailored to continuity in a pandemic.

The SEC also asked the registrant to answer several questions about its experience during the initial days of the pandemic, focusing on the broad topics of:

- disruptions caused by remote work;
- the resiliency of key vendors and third-party relationships;
- any preliminary weaknesses or unforeseen issues the firm had identified since implementing its BCP; and
- the firm's plans to assess the effect of the pandemic on its business and operations.

See "[Webinar Covers Key Topics for Fund Manager GCs and CCOs in Light of Coronavirus](#)" (Mar. 31, 2020).

Among those broad queries, there are several specific areas of focus that fund managers should take note of going forward.

## Remote-Work Risks

The OCIE Request List asks for additional details about aspects of a firm's BCP that are particularly applicable to the coronavirus pandemic, including:

- what personnel are working remotely;
- whether the BCP includes plans for all personnel working remotely for several weeks or months;
- whether it accounts for certain personnel being unable to operate remotely for several weeks or months; and
- whether the BCP contains contingency plans for essential personnel being unable to work or having limited capacity because they are caring for children.

During the current pandemic, the SEC is likely to home in on cybersecurity and compliance related to widespread remote work. Among the multitude of concerns in that context, the SEC will be particularly focused on fund managers' safeguards around material nonpublic information, suggested Guy F. Talarico, CEO of Alaric Compliance Services.

## Videoconferencing Software

Like many other companies, fund managers are relying on programs like GoToMeeting, Zoom, Skype and Microsoft Teams to stay connected throughout the pandemic, noted Talarico. Fund managers can encounter trouble if they do not invest in sufficient security or are lax in how they use those videoconferencing tools, he cautioned. "The wholesale use of videoconferencing is not something that most fund managers had prepared for in their BCPs."

Companies that send unsecured links to meetings, and who allow participants to join a meeting with their video turned off, may have difficulty knowing whether an unauthorized participant is listening in, Talarico observed. "If there's going to be one big directive out of all of this from the SEC, it's going to be that you need to have passwords, and you need to ensure that you know who is on the call."

With that said, it is possible for fund managers to use videoconferencing tools responsibly and in a way that satisfies the SEC's concerns, suggested Viola. As long as fund managers are mindful of the security implications of those communications, they should be able to answer the SEC's questions without too much additional heartburn, he opined.

See "[Strategies to Mitigate Evolving Cybersecurity Risks Introduced by a Fully Remote Workforce](#)" (May 19, 2020).

## Home Security

Home internet security, in general, will be a concern for the SEC and many fund managers, Solander noted. Not every adviser is going to be able to give each member of its compliance staff a laptop with a secure virtual private network it can trust. "We've heard from some

people who are scared to send marketing materials out from a home internet connection because they know that system is less secure than what they had in the office.”

Even with strong policies in place, employees need to be trained and reminded about cybersecurity and compliance risks related to remote work. “If you have employees that aren’t used to working from home and they are on their personal devices, that could be a problem,” Curran explained.

See “[Companywide Work From Home: Six Cybersecurity Considerations](#)” (Apr. 7, 2020).

## Books and Records

Finally, CCOs and other compliance personnel at fund managers need to prepare for the possibility that a firm’s remote workforce “may not be complying with the firm’s policies and procedures for properly maintaining books and records,” Curran cautioned. “That’s an area that all advisers have to focus on. Otherwise, they could face books and records deficiencies,” Viola concurred.

A fund manager’s duties under the books and records rule persist even if it needs to get creative with using WhatsApp or other tools to contact clients otherwise inaccessible at their office phone numbers, Viola added. “During these trying times, there might be a desperate attempt to get a hold of people and weaknesses where people are using social media or applications that are not properly storing and archiving data for SEC purposes.”

See “[Former OCIE Private Funds Examiner Explores Compliance Issues Introduced by the Coronavirus Pandemic and Mitigation Tips \(Part Two of Two\)](#)” (Apr. 21, 2020); and “[Failure](#)

[to Store Electronic Records in Proper Format May Result in Regulatory Enforcement Action](#)” (Jan. 12, 2017).

## Vendor Risks

A persistent concern for the SEC has been the need for firms to look beyond their own borders when considering disaster-related risks. To that end, the OCIE Request List contains several questions about vendor relationships, such as whether:

- remote work had led to reduced oversight of third-party vendors or service providers;
- the firm’s BCP addressed the resiliency of key third-party vendors, including regular review and updates of those vendors’ BCPs; or
- the firm is performing disaster-recovery coordination, including adopting a comprehensive strategy for dealing with all vendors’ BCPs.

See “[Fund Managers Must Supervise Third-Party Service Providers or Risk Regulatory Action](#)” (Nov. 16, 2017).

An investment adviser’s vendor-related risks depend on its particular strategy, structure and key relationships, but all advisers have certain third parties that are essential to the smooth operation of their businesses. “Those critical vendors are going to be different for each type of registrant, and they might include cybersecurity providers, trading counterparties, fund administrators and custodians,” Curran said.

PE sponsors, in general, will have less third-party risk than hedge funds because they are less liquid and less reliant on securities trading. “It’s probably a little harder for hedge funds

because PE and venture capital deals move a bit more slowly, and people are not even sure about closing deals right now,” Solander noted. “PE and venture capital firms may not have had as much pressure on their BCPs simply because of the way their business works.”

See “[Determining ‘Fair Value’ During a Crisis: Coronavirus’ Impact on Private Debt and Equity Valuations](#)” (May 5, 2020).

## Lessons From Prior SEC Oversight of BCPs

The SEC has made several efforts to address BCPs in the financial services industry since the attacks of September 11, 2001. Fund managers concerned about regulatory scrutiny can look to the lessons of the recent past for guidance.

The agency’s authority over fund managers’ BCPs is pursuant to a pair of rules adopted in 2003:

1. “Policies and Procedures” Rule: Investment advisers are required to have “adopted and implemented written policies and procedures reasonably designed to prevent violation of the [Investment Advisers Act of 1940 (Advisers Act)]” pursuant to Rule 206(4)-7 under the Advisers Act; and
2. “Compliance Procedures and Practices” Rule: “Fund boards [are required to] adopt written policies and procedures reasonably designed to prevent the fund from violating the federal securities laws” in accordance with Rule 38a-1 under the Investment Company Act of 1940.

The SEC has specifically taken the position that BCPs are included in each set of rules under the pretense that BCPs prevent an adviser from violating the respective rules during a significant business disruption. In fact, the SEC asserted that “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” in its [2016 proposed rule](#) on BCPs and related amendments to various Advisers Act rules (collectively, Proposed Rules) that were ultimately withdrawn.

Although the SEC has never implemented rules specifically addressing BCPs, the agency laid out its priorities in the Proposed Rules. The agency also published the Risk Alert after Hurricane Sandy. “The Proposed Rules and the Risk Alert are both very relevant, not outdated,” Curran emphasized.

See “[SEC’s National Examination Program Publishes Official List of Priorities for 2013 Examinations of Fund Managers and Other Regulated Entities](#)” (Feb. 28, 2013).

## 2016 Proposed Rules

The SEC’s Proposed Rules would have built on its existing guidance by mandating certain requirements for registered advisers’ BCP policies. Although the SEC acknowledged that the specifics of each BCP must be tailored to the advisers’ particular risks and operations, the Proposed Rules would have required all BCPs to address the following five core concerns:

1. maintenance of systems and protection of data;
2. prearranged backup offices;
3. communication plans;
4. a review of third-party service providers; and
5. transition plans to protect client assets in the event an adviser is unable to continue providing advisory services.

- communication plans; and
- BCP-testing policies.

Although they were never implemented, the Proposed Rules spelled out the SEC's preferred approach to BCPs and have been a helpful guide to registrants as they have developed policies in recent years. "Putting forth an explicit rule would help the Commission enforce a requirement that investment advisers have robust BCPs in place, but ultimately the language of the Proposed Rules still serves as best practice guidance for the industry," Curran explained.

For additional takeaways from the Proposed Rules, see "[Why Fund Managers Must Review Their Positions on Succession Planning and CCO Outsourcing \(Part One of Three\)](#)" (Apr. 14, 2020).

## Hurricane Sandy Risk Alert

The SEC published the Risk Alert in the wake of Hurricane Sandy's disruption of the operations of many financial firms based in New York and the East Coast. OCIE examined approximately 40 advisers' reactions to Hurricane Sandy, including their:

- preparation for widespread disruption;
- planning for alternative locations;
- preparedness of key vendors;
- telecommunications services and technology;

The SEC found that advisers generally had adopted written BCPs, including supplemental BCPs tailored specifically to Hurricane Sandy. The Risk Alert also detailed various weaknesses, however, in advisers' approaches to backup office locations, vendor continuity and technology access. For example, the SEC noted that even when advisers had backup offices, those backup offices were not geographically diverse and were also impacted by Hurricane Sandy.

The SEC found several weaknesses related to key service providers, noting that some advisers did not adequately review service providers' BCPs or consider the impact of service-provider failures on their abilities to implement their own BCPs. The SEC also reported that some vendors disincentivized BCP testing, finding that some advisers opted not to test their cloud-based disaster recovery solutions because of extra charges for that service.