

NOTICE OF REQUEST FOR PUBLIC COMMENT REGARDING A PROPOSED  
INVESTMENT ADVISER MODEL RULE AND GUIDANCE FOR  
BUSINESS CONTINUITY AND SUCCESSION PLANNING UNDER THE UNIFORM  
SECURITIES ACTS OF 1956 AND 2002

The Board of Directors of the North American Securities Administrators Association, Inc. (“NASAA”) is seeking comment on a proposed model rule and guidance requiring investment advisers to create and implement written procedures to address business continuity and succession planning under the Uniform Securities Act of 1956 and under the Uniform Securities Act of 2002 (“Model Rule” and “Guidance,” together “the proposal”)

Public Comment Period

The public comment period will remain open from August 1, 2014 until October 1, 2014. To facilitate consideration of comments, please send comments to Patricia Struck ([Patricia.Struck@dfi.wisconsin.gov](mailto:Patricia.Struck@dfi.wisconsin.gov)), Chair of the Investment Adviser Section and A. Valerie Mirko ([vm@nasaa.org](mailto:vm@nasaa.org)) at the NASAA Legal Department.

We encourage, but do not require, comments to be submitted by e-mail. We also welcome any general comments on the issues of business continuity and succession planning in connection with investment advisers.

Hard copy comments can be submitted at the address below.

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Background on the Proposal

The importance of proper business continuity and succession planning is one that state securities regulators witness regularly in their communities. Business interruptions take a variety of forms. While interruptions may result from natural disasters or other unexpected events that affect a large geographic region (such as Hurricane Sandy in October 2012) state securities regulators also see business interruptions that result from more localized disruptions to an advisory practice, such as fire, localized flooding, or disability or other unavailability of key personnel, including death. Issues of business continuity for smaller advisers include disaster and recovery planning as well as succession planning, which is particularly important for advisers functioning as sole proprietorships or with only one investment adviser representative.

The responsibility to maintain business continuity, protect clients from interruptions in an investment adviser’s business, and mitigate client harm in the event of a significant business interruption stem from an investment adviser’s post-registration recordkeeping and fiduciary

duty obligations. Therefore, the enclosed proposal, which includes both a proposed Model Rule and proposed Guidance on requiring investment advisers to create and implement written procedures to address business continuity and succession planning, is written pursuant to Section 203 of the Uniform Securities Act of 1956 and Section 411 of the Uniform Securities Act of 2002. We note that upholding such obligations are also inherent to an adviser's fiduciary duty, pursuant to Section 102 of the Uniform Securities Act of 1956 and Section 502 of the Uniform Securities Act of 2002.

As further outlined below, the proposal includes both a general, broad model rule, as well as more specific guidance on business continuity and succession planning for use by state-registered investment advisers. The purpose of this two tiered approach is to recognize the wide range of different business models of state registered investment advisers, as well as to provide investment advisers flexible guidance that can be utilized in developing an appropriate plan.

### NASAA Proposal on Business Continuity and Succession Planning

The proposal includes a general rule with respect to business continuity and succession planning. There are a wide range of different investment adviser operations currently operating in different jurisdictions. Therefore, a very specific, prescriptive rules-based approach to such planning issues may not apply equally to each state-registered investment adviser. For example, procedures will differ dramatically depending upon the size and number of locations from which the investment adviser operates. Despite the range of business models, however, a broad rule is necessary to require some sort of business continuity/succession plan and every plan should include certain general elements.

The proposal includes a model framework (Model Rule and Guidance) that would require that the adviser create and implement a business continuity/succession plan that covers a variety of topics. These topics include the protection, back-up, and recovery of books and records; establishing alternate means of communications with customers, key personnel, employees, vendors, service providers (including third-party custodians) and regulators (including but not limited to providing notice of a significant business interruption or the death or unavailability of key personnel); establishing a process for office relocation in the event of a loss of a principal place of business; the assignment of duties to qualified responsible persons in the event of death or unavailability of key personnel; and otherwise minimizing service disruptions and client harm that could result from sudden significant business interruptions.

The associated Guidance proposed with this Model Rule will provide investment advisers with an important framework in developing a business continuity and succession plan. The proposed Model Rule requires that an investment adviser's business continuity and succession plan be formulated consistent with the NASAA Guidance on Business Continuity and Succession Planning for State-Registered Investment Advisers, further described below.

## Proposed NASAA Guidance on Business Continuity and Succession Planning for State-Registered Investment Advisers

The Guidance (the “NASAA Guidance on Business Continuity and Succession Planning”) is intended to be considered in conjunction with the proposed Model Rule.

The Guidance covers a variety of issues that should be considered by investment advisers in developing their own business continuity and succession plan focusing on the issues unique to smaller businesses and the risks associated therewith. The Guidance is broad, allowing for investment advisers to tailor their business continuity and succession plans in a manner cost-effective to their business models.

The Guidance is also intended to relate and apply more directly to the small or mid-sized adviser. The Guidance discusses issues relating to recordkeeping and disaster recovery issues, but also focuses on issues most common to small advisers such the loss of key personnel (i.e. succession planning). The loss of key personnel is especially important considering that a significant subset of state-registered investment advisers tend to be sole proprietorships, single-member LLCs, or similar types of structures. Many firms have a single investment adviser representative. The loss of key personnel in such a firm due to death or other unavailability is not unusual, and can be harmful to clients absent proper planning. For example, the death or disability of a sole investment adviser representative can lead to an immediate cessation of activity with no notification or guidance to the firm’s former clients, who may heavily depend upon the adviser for financial services. The issue can be planned for in a variety of ways including an executed plan to wind down the investment adviser operation or having a succession plan for clients to use another investment adviser (keeping in mind relevant registration issues and non-assignment contract clauses). The Guidance does not prefer any one method of dealing with these potential issues, but raises specific issues based on state securities regulators’ collective experience so that advisers can consider those possibilities in developing their own business continuity and succession plan.

### Request for Comment

We seek comment regarding the entire proposal, which includes both the Model Rule and the Guidance. In particular, we seek comment regarding the following:

- (1) Should the Model Rule should be more specific, or incorporate any specific provisions not currently considered?
- (2) Have you encountered any specific business continuity/succession plan issues not currently covered or adequately addressed by the Guidance?
- (3) Should the Guidance be modified in any particular way?

## **Proposed Model Rule on Business Continuity and Succession Planning**

### **Model Rule (number to be determined). Business Continuity and Succession Planning**

Every investment adviser shall establish, implement, and maintain written procedures relating to a business continuity and succession plan. The procedures must be created and implemented in a manner consistent with NASAA's Guidance on Business Continuity and Succession Planning for State-Registered Investment Advisers. The procedures shall consider the size of the firm, type(s) of services provided and the number of locations of the investment adviser, and shall provide for at least the following:

1. The protection, backup, and recovery of books and records.
2. Alternate means of communications with customers, key personnel, employees, vendors, service providers (including third-party custodians), and regulators, including, but not limited to, providing notice of a significant business interruption or the death or unavailability of key personnel or other disruptions or cessation of business activities.
3. Office relocation in the event of temporary or permanent loss of a principal place of business.
4. Assignment of duties to qualified responsible persons in the event of the death or unavailability of key personnel.
5. Otherwise minimizing service disruptions and client harm that could result from a sudden significant business interruption.

**PROPOSED NASAA GUIDANCE ON BUSINESS CONTINUITY AND  
SUCCESSION PLANNING FOR STATE-REGISTERED INVESTMENT  
ADVISERS**

**SUBMITTED AS PART OF**

**A NOTICE OF REQUEST FOR PUBLIC COMMENT REGARDING A  
PROPOSED INVESTMENT ADVISER MODEL RULE AND GUIDANCE  
FOR BUSINESS CONTINUITY AND SUCCESSION PLANNING UNDER  
THE UNIFORM SECURITIES ACTS OF 1956 AND 2002 (August 1, 2014)**

## Table of Contents

A. Project Overview and Purpose	3
1. Definitions	3
2. Purpose of a Business Continuity Plan	4
B. Regulatory Requirements for Business Continuity Plans	5
1. NASAA Model Rule	5
2. State-Specific Business Continuity Plan Regulations	5
C. Planning for Unexpected Succession	6
1. Entity type	6
2. Designated Person	7
3. Service Issues	8
D. Development of the Business Continuity Plan	9
1. Business Interruptions – Disaster Recovery Questions	10
2. Loss of Personnel – Succession Questions	11
E. Testing and Maintenance	13
F. Case Studies	13
1. Constant Advisers, LLC – Disaster Planning	13
2. Gemini Associates, Inc – Loss of Key Personnel Planning	14
3. Mary’s Wealth Management – Sole Proprietor Planning	16

Appendix A: NASAA Model Rule on Business Continuity and Succession Planning

## **A. Project Overview and Purpose.**

The Investment Adviser Regulatory Policy and Review Project Group (the “Project Group”) of the North American Securities Administrators Association, Inc. (“NASAA”) has issued this Guidance on Business Continuity and Succession Planning for State-Registered Investment Advisers (“Guidance”). This Guidance accompanies the new NASAA Model Rule on Business Continuity and Succession Planning (the “NASAA Model Rule”).<sup>1</sup> The Guidance’s purpose is to provide practical assistance to state-registered investment advisers (“Advisers”) who are creating their own Business Continuity and Succession Plans and planning for unexpected or sudden events that might impact business operations.<sup>2</sup>

The new NASAA Model Rule requires registered investment advisers to have a Business Continuity and Succession Plan (“BCP”). This Guidance highlights critical elements that Advisers should consider adding to BCPs.<sup>3</sup> Advisers face significant risks if they become unable to serve clients, either temporarily or permanently. Failing to address these risks with a BCP can result in harm to Advisers’ clients, exposure to regulatory actions, and litigation for failure to satisfy legal, regulatory, or contractual duties.

### **1. Definitions.**

For purposes of this Guidance, the following definitions apply:

“Adviser” means a state-registered investment adviser entity, including a sole proprietorship.

“Adviser Representative” means an individual affiliated with an Adviser who provides investment advisory services. A sole proprietor may simultaneously be an Adviser and an Adviser Representative.

“BCP” means a Business Continuity Plan, including a Succession Plan.

“Significant Business Interruption” means an event or situation that significantly impacts the Adviser’s ability to provide advisory services to clients. Significant business

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<sup>1</sup> The full text of the new rules is contained in Appendix A.

<sup>2</sup> This Guidance is not intended for business continuity and succession that occurs in the regular course of business. It is intended for business continuity and succession planning in unexpected or unusual instances. Furthermore, this Guidance is prepared from a regulatory and compliance requirement perspective. It is not intended to provide in-depth guidance on crafting a Business Continuity and Succession Plan from a business perspective.

<sup>3</sup> In this Guidance, a Succession Plan is considered to be a part of an overall Business Continuity Plan.

interruptions depend on the type of event, the effect the event has on the Adviser's business, and the duration of the interruption.

"Custodian" means a financial institution that holds funds or securities of an Adviser's client for safekeeping.

"FINRA" means the Financial Industry Regulatory Authority.

"Form ADV" means the Uniform Application for Investment Adviser Registration.

"Guidance" means this Guidance on Business Continuity and Succession Planning for State-Registered Investment Advisers.

"IARD" means the Investment Adviser Registration Depository, the electronic filing system that facilitates investment adviser registration.

"NASAA" means the North American Securities Administrators Association, Inc.

"NASAA Model Rule" means the NASAA Model Rule on Business Continuity and Succession Planning, outlined in Appendix A.

"SEC" means the United States Securities and Exchange Commission.

"Succession Plan" means a Succession Plan for a situation in which an individual is unexpectedly unable to perform functions for the Adviser.

## 2. Purpose of a Business Continuity Plan.

The most common purpose of a BCP is to have processes and procedures in place to ensure that critical business functions can continue during and after a disaster or other significant business interruption. BCPs outline actions Advisers should take if utility outages, catastrophic natural disasters, national emergencies, acts of terrorism, or other types of disturbances disrupt day-to-day business operations. Advisers' BCPs should reflect comprehensive approaches to reduce and manage risks associated with disasters, significant business interruptions and work stoppages.

All BCPs should include Succession Plans. In the financial services industry, business relationships often mesh with personal relationships. In addition, many state-registered advisers have a single-owner Adviser Representative. Without proper planning, the unexpected loss of executives, key personnel or owners can be disastrous to the



business and to clients. Advisers have a fiduciary duty to act in the best interest of their clients, and it is in the best interest of clients for Advisers to institute procedures to ensure continuity of services and the day-to-day operations of the business, or to smoothly wind down Advisers' businesses in the event of death, disability or incapacity.

## **B. Regulatory Requirements for Business Continuity Plans.**

### **1. NASAA Model Rule.**

The new NASAA Model Rule requires Advisers to establish and maintain a written BCP. An Adviser's plan should include provisions that:

- Consider the size, number of locations and services provided by the Adviser.
- Provide for the protection, back-up and recovery of the Adviser's books and records.
- Have a method for communications with customers, employees, and regulators.
- Provide for office relocation, if necessary.
- Provide for responsible persons to act in the event of death or disability of key personnel.
- Contain methods to minimize service interruptions and client harm.

### **2. State-Specific Business Continuity Plan Regulations.**

Various states have a state-specific BCP regulatory requirement. State rules may differ from the NASAA Model Rule. Advisers should check with the securities regulators in their home states and with any other states in which they are registered to ascertain specific state requirements.

In addition, states may interpret their regulatory requirements (or an Adviser's fiduciary duty) to implicitly require BCPs. In the absence of any state-specific requirements, Advisers have a fiduciary duty to have policies and procedures in place that minimize risk to clients and ensure clients' access to their assets.

### **C. Planning for Unexpected Succession.**

Planning for an unexpected succession situation is an important part of a BCP.<sup>4</sup> A sudden loss of key personnel is fairly common and does not alleviate an Adviser's fiduciary duty to its clients or its obligation(s) to comply with regulatory requirements. In creating a Succession Plan, an Adviser should consider how an unexpected loss of key personnel might cause difficulties for the Adviser's clients. The Succession Plan should address these possible difficulties.

While there are some succession issues that apply to every Adviser (*e.g.*, every Adviser needs a designated regulatory contact person), each Adviser must also tailor its Succession Plan to the Adviser's needs. When drafting a Succession Plan, each Adviser must consider its entity type, the designated person who will execute the plan (and that person's authority and capacity to do so under potentially difficult circumstances), and the services the Adviser provides.

#### **1. Entity Type.**

An Adviser's business entity structure will affect the types of items that should be addressed in the Adviser's Succession Plan. State law provisions could affect the Adviser's ability to conduct business. For example, a state's applicable business entity law may trigger the dissolution of the entity, or impose other consequences, responsibilities or limitations on the entity, its owners or managers, upon the death of members, partners, or shareholders. In addition, Advisers are often organized as sole proprietorships or other legal entities such as corporations. The Succession Plan should be drafted so that it does not conflict with any applicable state laws that apply to the Adviser's form of business entity.

In a sole proprietorship, the client's legal relationship is with the sole proprietor, who is often the only Adviser Representative. With the death or permanent disability of the Adviser Representative, the sole proprietorship itself may legally terminate as an entity, as would any powers of attorney, advisory contracts, and other client agreements. The deceased (or otherwise incapacitated) sole proprietor is likely to be the only regulatory contact and may be the only person who would be able to access electronic client files or authorize rebates of prepaid fees. There are many additional issues, such as probate, that are unique to sole proprietorships and that affect the implementation of a Succession Plan. Therefore, the Adviser should have a Succession Plan that will immediately address these issues when an Adviser Representative becomes unavailable.

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<sup>4</sup> Succession planning in this Guidance focuses on planning for an unexpected succession.

If the Adviser is organized as a separate legal entity,<sup>5</sup> the client's relationship is generally with that entity. Therefore, the Adviser should have a Succession Plan that addresses how to minimize the effect a sudden loss of key personnel may have on the Adviser's ability to serve its clients. The corporate structure may conflict with client needs and the ability to implement the Succession Plan. For example, an Adviser owned by one or more people may automatically dissolve upon an owner's death, effectively terminating client contracts. Conversely, the owner's interest might automatically transfer to an heir who is unable or unwilling to perform all business functions or to follow the Succession Plan.

The death or unavailability of key personnel may also change the Adviser's business relationship with creditors and outside vendors, which may also result in a reduction in the credit available for the Adviser.

Advisers should consider the following items when drafting a Succession Plan to ensure that the Succession Plan adequately accounts for the risks related to the business entity:

- Are the clients' investment advisory contracts with an individual or a legal entity? Does an Adviser Representative's death or unavailability affect the advisory agreements?
- How will the Adviser ensure continuity of services to the client?
- What will happen in the event of death or incapacity of the manager of discretionary accounts?
- How will the death or unavailability of certain individual owners affect the legal ownership of the firm and the registration status of the entity and/or its new owner(s)?
- Does the Adviser only have one person with IARD access? What will happen if that contact is no longer available?
- Who is responsible for dealing with creditors and vendors?
- Who will rebate advisory fees if fees are paid in advance?

## 2. Designated Person.

The availability and registration status of an individual with knowledge of the Adviser's business is an important factor for developing a Succession Plan. Internal expertise to operate systems such as the IARD may be lost in the event of a sudden unavailability of key personnel. Substantive knowledge regarding client services and sophisticated products trading may need to be replaced. If an Adviser Representative has unique knowledge of client investment objectives (e.g. certain suitability and financial

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<sup>5</sup> This may include an 'S' or 'C' corporation, Limited Liability Company or Partnership.

information), and that information is not in writing, such knowledge would also be lost. An Adviser should evaluate the availability of additional personnel when creating the Adviser's Succession Plan.

Advisers with only one Adviser Representative may need to have a designated individual who is familiar with its business operations to properly wind down the Adviser's business or facilitate a transfer of its accounts. If the designee would have access to confidential client information, the Adviser must ensure that it has proper pre-arranged client authorization to share this confidential information.

In the event the sole Adviser Representative is unexpectedly unavailable, Advisers often designate a spouse, attorney, accountant, or another Adviser to execute the Succession Plan. When selecting a designee, the Adviser should consider the capability of the designee to fulfill this responsibility in the potentially stressful circumstances that would require prompt execution of the Succession Plan. A person cannot provide advisory services for compensation unless he or she is registered with the State's securities regulator(s) or exempt from registration.

With proper planning, Advisers with multiple Adviser Representatives may be able to continue to offer all advisory services with limited disruption to clients. An Adviser should carefully review all legal documents and advisory contracts and identify any changes necessary to ensure the success of the Succession Plan. The loss of an owner may result in an assignment of its client accounts or contracts which would require client consent. In such a case, and even with client consent,<sup>6</sup> a succession by amendment or succession by application filing with the state may be required.<sup>7</sup> The Adviser should consider the applicable state requirements when drafting the Succession Plan.

### 3. Service Issues.

The Succession Plan should be tailored to the services the Adviser offers. An Adviser that offers one-time financial planning services to clients should have a different Succession Plan than a discretionary asset manager. The Succession Plan should be structured to address the Adviser's responsibilities to clients and regulators. This may include identifying the rightful recipient for return of any unearned pre-paid client fees and the specific method by which those fees will be promptly returned.

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<sup>6</sup> A state may allow a client to grant a prearranged consent that will only become effective if a specified event occurs. Check with your home state before executing such an agreement.

<sup>7</sup> You should contact each state in which you are registered to determine that state's requirements for successor registration. Also, please note that the new Adviser may be required to execute new advisory contracts with its clients.

If the Adviser provides asset management services, the Succession Plan should ensure that clients are immediately notified of any interruptions in service. Clients need to know whether their accounts are being managed, where the accounts are held, and how to access their accounts. A Succession Plan cannot assign the contract to another Adviser without the client's consent.

Regardless of whether the Adviser acts as a qualified custodian or uses a third party for that purpose, the Succession Plan should address how client accounts will be managed and how clients can access their assets in the event of loss of the Adviser's key personnel.

If the Adviser has custody of client assets, the Adviser will need to ensure that clients are authorized and able to obtain their assets. If the Adviser manages pooled assets, the Succession Plan will need to address the issues involved with the liquidation or continued management of those assets.

If the Adviser's clients are invested in any illiquid, time-sensitive or high-risk securities, the Succession Plan may need to include specific instructions for each type of asset. The Succession Plan should detail how to provide resources to clients who may not have the expertise to liquidate such positions appropriately or have the desire to take over management of these securities. An Adviser can consider having an advance arrangement with another Adviser to assist its clients.

Advisers should determine what information, if any, clients should or need to know about the plan to ensure that the plan can be properly executed. This may include providing all clients with a copy of the entire plan or informing clients of the identity of the person who will contact them if the plan is implemented.

#### **D. Development of the Business Continuity Plan.**

Creation of an effective BCP begins with brainstorming and thinking through scenarios that may cause sudden business interruptions. Below is a list of questions Advisers should consider in drafting BCPs.<sup>8</sup>

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<sup>8</sup> The Securities and Exchange Commission ("SEC") and the Financial Industry Regulatory Authority ("FINRA") have both published documents regarding BCPs. Some Advisers may find these resources helpful when drafting their individualized BCPs. The SEC references BCPs in its *Interagency Paper on Sound Practices to Strengthen the Resilience of the US Financial System* (SEC Release No. 34-47638) and in its *SEC Examinations of Business Continuity Plans of Certain Advisers Following Operational Disruptions Caused by Weather-Related Events Last Year* (Volume II, Issue 3, August 27, 2013). FINRA adopted Rule 4370 regarding business continuity planning and has published a *Small Introducing Firm Business Continuity Planning Template* for broker-dealers (revised May 12, 2010).

1. Business Interruptions – Disaster Recovery Questions.

- a) What risks could interrupt operations and client service? Consider:
- i. Natural disasters;
  - ii. Equipment and/or system failures and destruction of records;
  - iii. Terrorist acts;
  - iv. Unexpected loss of a market or service provider;
  - v. Unexpected loss of key technology service providers.
- b) How can these risks be managed? Consider these items and whether there will be a different plan of action for each item depending on whether the interruption is short-term or long-term:
- i. Data backup and recovery (hard copy and electronic);
  - ii. Redundancies in mission-critical systems;
  - iii. Financial and operational assessments;
  - iv. Communications with regulators, clients and employees;
  - v. Communications with broker-dealers, custodians and service providers;
  - vi. Short or long-term office relocation;
  - vii. Advance consent from clients for assignment to another Adviser;
  - viii. Obtaining critical business services from providers;
  - ix. Client access to information and accounts.
- c) How will employees be trained about the BCP and their duties during a sudden business interruption?
- d) How will the BCP be updated? How often will the BCP be updated? Consider the following possibilities:
- i. Conduct an annual desk-top exercise or scenario to test the adequacy of the BCP;
  - ii. Review the BCP at staff meetings;
  - iii. Review the BCP when material changes occur with personnel, firm location; software, communication equipment or service providers.
- e) How will the BCP be well-documented and available to key personnel both within the current location and remotely?
- f) Does the BCP fit the Adviser's current method of business operations? Consider the following:
- i. Types of services provided (asset management, custodial, etc.);
  - ii. Type of legal entity;
  - iii. Number of office locations;

- g) If the Adviser is creating a BCP for a small firm, how will the BCP accommodate the specific considerations that small firms may have?
  - i. Adequacy and allocation of resources;
  - ii. Selection of off-site backup facilities;
  - iii. Ensuring redundancy of knowledge within staff;
  - iv. Designation of personnel responsible for executing the Succession Plan.

## 2. Loss of Personnel – Succession Questions

The following is a non-exhaustive list of issues that should be considered in developing a Succession Plan:

- a. How will the clients be informed of the death or disability of key personnel? Who will make this notification?
- b. What does the Adviser expect that clients should do in the event of a loss of key personnel? How are those expectations communicated to the firm's clients prior to a loss of key personnel? Should this information be included in the Adviser's Form ADV Part 2A? Should this information be included in the Adviser's advisory agreement?
- c. Will the Adviser continue to service client accounts?
  - i. If an equity owner dies, what will happen to the advisory firm? Will the business be sold to the partner's family or heirs? Will the business buy out the partner's family or heirs? Will the Adviser take on the late partner's heirs as associates? Will any of these individuals need to be registered?
  - ii. Will the Adviser adopt an "internal" or "external" Succession Plan? In an internal plan, the Adviser transfers the advisory responsibilities to another Adviser Representative currently in the firm. With an external Succession Plan, the Adviser transfers client management to another advisory firm.
  - iii. Will the change result in an assignment? If so, how will the Adviser receive the client consent before the assignment?
  - iv. Will the Adviser reorganize under a different name with different management?
  - v. Who will update the Form ADV? Does this person have IARD account access?
  - vi. How will the successor access the Adviser's books and records (including the electronic records)?
  - vii. Who will update the custodian (broker-dealer, bank, etc.)? Does the custodian require this contingency to be set-up in advance?
  - viii. If it is a temporary disability, will the Adviser or Adviser Representative be able to restore his or her previous accounts?

- d. Will the Adviser close down?
  - i. Has the firm communicated to other individuals (attorneys, accountants, spouses, etc.) how to dissolve the firm in the case of death or permanent disability of the firm's key personnel?
    - i. Does that other individual need to be registered?
  - ii. Who will inform the custodian (broker-dealer, bank, etc.)? Does this person have authorization on the Adviser's account? Does the custodian require this contingency to be set-up in advance?
  - iii. Who will file the Form ADV-W to terminate the Adviser's registration? Does that person have IARD account access?
  - iv. Who will store the Adviser's books and records for the required retention period?
  - v. How will clients know how to contact their custodians?
  - vi. Will the Adviser recommend a new adviser? If not, do the clients have the expertise to take control of illiquid, low volume, volatile or hedged positions that had previously been managed by the Adviser (such as private placements, options, or micro-cap securities)?
  - vii. Will the Adviser want to set-up a possible replacement Adviser? If so, will the new adviser contact the clients? Does this require prior client consent to share this information? How and when will the new adviser execute new contracts with the clients?
  - viii. Will the business liquidate?
- e. If the firm is a sole proprietor (or has a single investment adviser representative), will clients be able to manage their own affairs (including buying and selling securities, if necessary, under prevailing market conditions) until such time as they can engage a new adviser?
- f. If the Adviser manages assets, do clients know the location of all of their assets and how to gain access to their accounts?
- g. If the Adviser manages a fund and something happens to the managers, will the fund be liquidated? If so, how will liquidation be initiated? Who will notify the liquidator? If not, what will happen to the fund?
- h. If the Adviser charges fees in advance, what is the process of refunding unearned fees?
- i. Are there additional tax considerations that have to be included in the Succession Plan?



- j. How will the Adviser inform its regulator(s) of the plan and any updates to the plan?

#### **E. Testing and Maintenance.**

An Adviser should periodically test the BCP to ensure that it is adequate, effective and current. The BCP should be updated to reflect any changes in circumstances, vendors, contact information, or designated duties. Suggested areas to test include the following:

- Hardware functions at the alternate business location;
- Easy access to back-up files;
- Verification of current contact information and any designated duties for employees, clients and critical business partners;
- Verification of current vendors, service providers, software and equipment;
- Conformance of current business practices with the plan; and
- Conformance to regulatory requirements.

#### **F. Case Studies.**

These case studies are intended to provide another way to think about the items that should be included in a BCP. Each case study consists of a fact pattern followed by items to consider. The fact patterns demonstrate that unexpected events will affect Advisers in large measure based on how the Adviser runs its business. The list of “issues to consider” highlights potential risks to an Adviser. In order to create a comprehensive BCP, an Adviser should understand how the business normally runs so that it can determine the best way to continue operations when unexpected events occur. Case study No. 1 primarily focuses on business continuity issues associated with natural disasters, case study No. 2 deals with general loss of key personnel and succession issues, and case study No. 3 concentrates on sole proprietor business continuity and succession issues.

##### **1. Constant Advisers, LLC – Disaster Planning**

You own an Adviser named Constant Advisers, LLC (“Constant”), which employs two administrative assistants and three Adviser Representatives. The firm is registered in your home state only. The firm operates two offices, one in the western part of the state (with one assistant and two Adviser Representatives) and one in the central part of the state (with one assistant and one Adviser Representative). Client records are stored in filing cabinets at each location, and the Adviser Representatives store their clients’ records at the location from which they conduct business. There is one central depository for client records maintained by The Cloud, Inc., but only client records from prior years are located there.

All client funds and securities are held in custody by Secure Securities, LLC, located in Boston, MA. Every Adviser Representative has discretion in client accounts, and every client allows the firm to deduct the quarterly management fee. The firm maintains two operating accounts: one at Secure Securities, LLC and one at HomeTown Bank, based in your home state.

The mission-critical vendors for both offices include CityTel for telephone, CableCity for Web access and Watts-Up for power.

On Monday night, your state experiences torrential rain and widespread flooding. The governor, concerned about washed out roads and bridges, declares a state of emergency, forbidding all travel through Friday. The power at both offices of Constant is out for four days.

Issues to Consider:

- a. You determine the firm will continue to conduct business. Explain how the firm will effect transactions for customers.
- b. After two days, you determine that the firm cannot continue to conduct business. Explain how your firm will ensure that customers have access to their funds and securities.
- c. What steps could Constant take to mitigate any loss of service from its critical vendors?
- d. On Thursday during the extended power outage, fire destroys the building in the central part of the state. Explain how your firm stores copies of records, what records your firm backs up (and the schedule for preparing the back-up files), what records would be lost, and what records are maintained by the custodian.
- e. Assume this disaster occurs during the week when you intended to deduct quarterly asset management fees from client accounts. How do you plan to collect the fees? How will you provide the required notification to clients of the fee deduction?

2. Gemini Associates, Inc – Loss of Key Personnel Planning.

You work for Gemini Associates, Inc. (“Gemini”) as an Adviser Representative. Gemini is a C-corporation owned by Jack and Jill Hill and conducts business on a calendar year basis. Jack and Jill started the firm ten years ago. On the Form ADV, Jack and Jill are designated as each owning 50% of Gemini. Jill is not securities-licensed by your state and has no involvement in the daily activities of the Adviser. Jack and you are the only

Adviser Representatives. When Jack and Jill hired you two years ago, they said they were hoping to groom someone to take over the daily operations of the firm and to eventually buy their shares. However, a written agreement to that effect has never been executed.

Revenues for Gemini include the following:

- Asset management fees (billed quarterly).
- Financial planning fees (billed upon delivery of the financial plan based on an agreed-upon fee).
- Insurance commissions earned by Gemini's licensed insurance producers and assigned to the Adviser.

You each maintain separate books of business but divide the office responsibilities. You are responsible for daily office operations including the firm's accounting. Jack is responsible for maintaining the website and for regulatory compliance. Only Jack has the password to the IARD. The firm is partially funded by a line of credit obtained from HomeTown Bank by Jack personally. The office lease and all software licenses are in Jack's name. You each purchased your own laptop computers and were reimbursed by the company. You and Jack both back up your computers daily on personal flash drives.

Jack is diagnosed with late-stage terminal cancer. He and Jill leave the state to explore experimental treatments for an unspecified period of time.

Issues to Consider:

- a. Explain if or how the firm will continue to conduct business.
- b. How will clients and regulators be informed of Jack's unavailability?
- c. How will you be paid?
- d. After one month, one of Jack's clients contacts you on your cell phone wanting to liquidate some of her stocks. How do you respond?
- e. After two months, a client contacts you and asks when her financial plan will be delivered. This was one of Jack's clients, and you were not involved in preparing the plan.
- f. After three months, you finish a financial plan for a client by using the financial planning software loaded on your personal laptop. The plan had to be developed before Jack left the state. Are you able to deliver the plan? Are you entitled to all, some or none of the collected fee?
- g. If you decide to leave Gemini before Jack returns, what are your obligations to the Adviser's clients and the firm?

- h. Do Jack and Jill's oral statements about selling their shares to you affect your duty to the firm and the clients?

### 3. Mary's Wealth Management – Sole Proprietor Planning.

Mary Smith is an Adviser operating her advisory business as a sole proprietorship doing business as Mary's Wealth Management. Most of Mary's clients are elderly and rely on her to manage their accounts on a discretionary basis. Mary collects advisory fees quarterly in advance. She deposits the fees in a checking account in which her husband, Henry, has joint ownership.

Three months ago, Mary and Henry purchased a small building. They own the building jointly. Mary leased three offices in the building. She and the tenants executed two-year leases with Mary as the sole lessor. The tenants paid six months rent in advance. The rent was deposited in the joint checking account. Mary also used her business credit card to purchase new furniture, a computer, a desk, and a television for her office. The total cost was \$20,000.

Mary dies in a car accident a week after the beginning of the quarter. Under state law, Henry becomes the sole owner of the joint checking account and building. A few of Mary's clients discover that she died after reading her obituary in the local newspaper and contact Henry about their prepaid quarterly fees. Henry refuses to refund the fees claiming that he owns all the money in the joint checking account. Additionally, he does not send out a notice of Mary's death to Mary's clients or to the State's securities regulator. Instead, Henry removes all the recently purchased items from Mary's office and retains a realtor to sell the building despite objections from the two tenants. Henry also fails to make any payments on the credit card Mary used to purchase the new furniture and equipment and as a result, Mary's creditors have filed a claim against her estate. Mary's clients have also filed claims against her estate to recover the unearned fees but they are unsecured creditors.

#### Issues to Consider:

- a. Mary should have had a Business Continuity and Succession Plan to prepare for this type of event. What could she have included in her BCP to minimize client harm? What could she have done to attempt to ensure that her clients and the state would have been promptly notified?
- b. If Mary had created a limited liability company or a C-corporation for the Adviser instead of operating as a sole proprietorship, how would that have affected the situation?

c. What type of arrangement could she have in place to refund unearned fees? If Mary had charged fees in arrears, how would that have affected the situation for her clients?

d. How could she have tailored her plan for her elderly clients? If she wanted her clients to transition to another Adviser, what proactive steps would she have needed to take to help facilitate that transition? How could she have obtained client permission to share confidential client information? If the transition would result in an assignment, how and when would clients consent? How would the new Adviser contact the custodian?

## **Appendix A NASAA Model Rule on Business Continuity and Succession Planning**

### **Model Rule (number to be determined): Business Continuity and Succession Planning**

Every investment adviser shall establish, implement, and maintain written procedures relating to a Business Continuity and Succession Plan. The procedures must be created and implemented in a manner consistent with NASAA's Guidance on Business Continuity and Succession Planning for State-Registered Investment Advisers. The procedures shall consider the size of the firm, type(s) of services provided, and the number of locations of the investment adviser, and shall provide for at least the following:

1. The protection, backup, and recovery of books and records.
2. Alternate means of communications with customers, key personnel, employees, vendors, service providers (including third-party custodians), and regulators, including, but not limited to, providing notice of a significant business interruption or the death or unavailability of key personnel or other disruptions or cessation of business activities.
3. Office relocation in the event of temporary or permanent loss of a principal place of business.
4. Assignment of duties to qualified responsible persons in the event of the death or unavailability of key personnel.
5. Otherwise minimizing service disruptions and client harm that could result from a sudden significant business interruption.