

Lessons from COVID-19: Operational Risk and Resilience



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Introduction

The COVID-19 pandemic continues to test the operational resilience of financial services firms in an unprecedented manner. In this paper, we analyze operational challenges faced by the asset management industry during the pandemic to date, and how the industry has responded to these challenges. The vast majority of asset management firms were able to function well over this period, demonstrating remarkable resilience. Technology played a critical role in delivering a positive customer experience, increasing the efficiency and accuracy of operational workflows, and enhancing performance by supporting multiple aspects of the investment process.¹ However, there were isolated areas of concern where improvements may be warranted. In this *ViewPoint*, we review the experience of asset managers during the period beginning in March 2020, and we provide recommendations to further bolster operational resilience across the asset management industry.

Regulatory environment

Following the initial bank-focused regulatory response to the Global Financial Crisis (GFC), policy makers broadened their focus to non-banks and market-based finance. Over the course of this review, policy makers enhanced their understanding of the risks across different business models in financial services, including operational risks.

Policy makers recognized that asset managers face different risks than insured financial institutions, such as banks, that engage in balance sheet-based activities. Losses and disruptions experienced by an asset manager do not automatically cause losses for clients and are unlikely to result in systemic risk. However, disruptions can undermine investor confidence and care should be taken to mitigate this risk.

The global focus on risk in the asset management sector led to a review of existing regulation and the introduction of additional rules pertaining to operational risk. Regulators and industry participants reviewed operational risk management frameworks under business as usual (BAU) and stressed scenarios, BCM and business continuity planning (BCP) in cases of operational and/or external events, and plans for orderly winddowns; this review led to several policy recommendations. One of the most prominent recommendations was in the Financial Stability Board’s (FSB) January 2017 report on “Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities” (FSB report).² Among the FSB’s fourteen recommendations for strengthening the asset management industry was a recommendation addressing operational risks and challenges in transferring client accounts and investment mandates from one asset manager to another.

The opinions expressed are as of October 2020 and may change as subsequent conditions vary.

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Key Observations and Recommendations

1. Following the Global Financial Crisis (GFC), greater regulatory focus was placed on risks inherent in asset management. One outcome of this review was more robust regulatory frameworks for operational risk management and business continuity planning, which helped firms be more prepared for the COVID-19 crisis.
2. During COVID-19, the majority of asset management firms transitioned – in a matter of days – from having most of their workforce in offices to almost all employees working from home.
3. A key reason for this smooth transition was the robust BCM plans that asset managers have developed to address various potential adverse scenarios.
4. While asset management firms have continued to demonstrate exceptional resilience during COVID-19, reliance on third party vendors with a geographically concentrated presence or functional centers located in select geographies raised some concerns, as did their reliance on fourth-party vendors.
5. During COVID-19, two areas that experienced disruptions were pricing services and the delivery of shareholder documents.
 - The unusual market volatility and a decrease in trading of certain securities created challenges for pricing providers, who were, in some cases, unable to deliver accurate real-time pricing information. We encourage regulators to work with these vendors to ensure robust BCM, including processes regarding reaction time and reliability.
 - In the US, many shareholder documents are required to be delivered via physical mail. During the pandemic, there were production and mail delays that prevented these documents from being delivered in a timely manner. To prevent this type of disruption and address investor preferences for electronic delivery of financial documents, we recommend the SEC expand the use of electronic delivery as the permitted default for all regulatory fund documents.
6. We recommend that all asset management firms practice robust vendor management with continuous monitoring and resiliency health checks of third-party service providers. This should include reviews of BCM plans, disaster recovery plans (which includes the frequency and robustness of test strategies), third party vendor management programs (fourth party oversight), financial health, and information security practices.
7. We recommend policymakers continue to work with asset management firms to ensure that a thorough assessment of a vendor’s business continuity management program, disaster recovery planning, reliance on critical fourth-party providers, and information security systems is an integral part of the vendor selection and review process.

“ Authorities should have requirements or guidance for asset managers that are large, complex, and/or provide critical services to have comprehensive and robust risk management frameworks and practices, especially with regards to business continuity plans and transition plans, to enable orderly transfer of their clients’ accounts and investment mandates in stressed conditions.

- FSB Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities

In line with this recommendation, most jurisdictions reviewed existing guidance, and in some cases published new standards for risk management, including operational risk management and BCP. This review follows robust guidance already in place prior to the FSB report. For example, both European fund regulation directives – Undertakings for the Collective Investment in Transferable Securities (UCITS) and Alternative Investment Fund Managers Directive (AIFMD) – require appropriate risk management practices for asset managers, including business continuity management. Supervisors in several European Countries use the AIFMD requirements as minimum standards.³ In the US, the Securities and Exchange Commission (SEC) updated its guidance on business continuity planning for registered investment companies in 2016.⁴

Exhibit 1: BCP Regulation around the world

Markets regulators in various jurisdictions have developed operational risk management frameworks for asset management. Below is a representative sample from jurisdictions around the world.

Australia: Australian financial services (AFS) licensees have an ongoing legal obligation to have adequate risk management systems under the Corporations Act.⁵ These systems are fundamental to mitigating exposure to relevant risks and informing business decision making. Responsible entities as AFS licensees are subject to this ongoing obligation. Regulatory Guide 259⁶ sets out guidance for how responsible entities may comply with this obligation, including establishing and maintaining risk management systems suitable for the responsible entity's business and operations.

Germany: The German Supervisor BaFin was empowered under the Investment Act (KAGB) to issue specific guidelines for banks and investment firms, including setting rules on the organizational and operational structure, risk management and control processes, and risk and compliance functions.⁷ BaFin used these powers to issue the "Mindestanforderungen an das Risikomanagement von Kapitalverwaltungsgesellschaften" (KAMaRisk),⁸ under which all firms in Germany are expected to have BCM plans in place. The requirements in KAMaRisk are designed as minimum standards. Under these guidelines, the German supervisor expects firms to plausibly explain and demonstrate their resilience in cases of operational or external events.

Hong Kong: The Fund Manager Code of Conduct (FMCC)⁹ sets out guidance and requirements for fund managers regarding maintaining resources, satisfactory internal controls and compliance procedures, and risk management governance structure and procedures. In addition, the Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the Securities and Futures Commission (SFC)¹⁰ set out various key controls and attributes of an adequate internal control system. The SFC suggests possible effective methods of achieving those attributes, including supervision, information management, operational controls, and risk management.

Ireland: The Central Bank of Ireland (CBI) has set out requirements for Fund Management Companies (FMC).¹¹ Each FMC must have BCM arrangements in place and review and monitor implementation. The CBI must be satisfied with the BCP/BCM of any delegates. During the initial COVID-19 period, the CBI interacted with firms on a daily basis to discuss flows. In addition to this, the CBI requested regular calls and one-to-one meetings with senior staff regarding BCP implementation, flows, and other market events.

Japan: The Financial Services Agency (FSA) has issued Supervisory Guidelines (SGs) for each type of financial institution, many of which include a section on Business Continuity Management.¹² The SGs on BCM for asset managers require information and data/cyber security measures; avoidance of geographic concentration of back-up centers; determination of expected recovery time for redemption of investment trust funds; involvement by boards of directors in the set-up and review of BCP; and periodic reviews by internal audit or independent third party reviewers.

Luxembourg: Implementing and maintaining an adequate business continuity policy is a legal requirement in Luxembourg.¹³ Organizational requirements for investment firms in Luxembourg are further specified by guidance in the form of circulars and include the necessary monitoring for BCM and requirements ensuring business continuity in cases of disruptions. The CSSF issued its basic guidance on organizational requirements in 2018¹⁴ and regularly updates the individual expectations for firms. For example, investment firms in Luxembourg were required to report large redemptions from March 10 until June 2, and the CSSF established an automated process for monitoring any significant events and relevant redemptions.¹⁵

The Netherlands: Dutch law requires asset managers to set up their operations in a way that ensures a controlled and ethical conduct of business. This includes business continuity plans and management.¹⁶ The Dutch Central Bank (DNB) supervises BCM and crisis management where applicable. In March 2020, DNB recognized that the long-term effects of the COVID-19 pandemic will most likely be different from earlier (shorter) disruptions. DNB expects that BCPs include tracking the COVID-19 developments, mapping and analyzing potential consequences, assessing the adequacy of existing BCP (including pandemic scenarios in test strategies), taking into account changing behavior of employees/clients, and verifying that service providers have adequate measures in place.

Exhibit 1: BCP Regulation around the world (cont'd)

Singapore: The Monetary Authority of Singapore (MAS) has issued Regulations, Notices, and Guidelines to financial institutions, including asset managers, covering operational management requirements, including expectations around sound Business Continuity Management. MAS has issued Guidelines on Risk Management Practices,¹⁷ which provide guidance for operational risk management frameworks such as business continuity and outsourcing, and Guidelines on Business Continuity Management,¹⁸ which set out sound BCM principles.

United Kingdom: In 2001, the FCA introduced guidance on business continuity planning for all firms on a general level in its handbook (chapter SYSC 3.2).¹⁹ The FAQs require firms to take detailed precautions, depending on a firm's business model and circumstances. In December 2019, British regulators launched a shared policy summary and coordinated consultation papers on new requirements to strengthen operational resilience in the financial services sector to ensure greater coherence in business continuity planning among regulated firms in the UK.²⁰ The new proposals have a strong focus on the identification of key functions. The consultation period ended in October 2020, and the final changes to the FCA Handbook are expected to be published in the first half of 2021.

United States: In June 2016, the SEC updated its guidance on business continuity planning for registered investment companies.²¹ The guidance outlined a number of measures funds should consider as they evaluate their plans for mitigating business continuity risks for funds and investors. These recommended measures include back-up processes and contingency plans, monitoring incidents and communications protocols, understanding how the BCPs of different critical service providers relate to each other, and contemplating various disruption scenarios both internally and at third party service providers. In addition, in June 2016, the SEC issued a proposed rule on Adviser Business Continuity and Transition Plans that would require all investment advisers to have business continuity plans in place that address, among other things, the role of critical third party service providers in the adviser's operating model.²² While this proposal was not finalized into a rule, many advisers adopted these principles as best practices.

Business continuity management in asset management

This paper focuses on BCM of asset managers. For information on risk management and BCM at the mutual fund level, see our [ViewPoint Fund Structures as Systemic Risk Mitigants](#).

At a high level, BCM in asset management focuses on the resumption of business and should be thought of as a separate set of policies and procedures from transition planning, which is focused on the winding down of a business. In practice, transition plans are highly unlikely to ever be used, whereas BCM plans are likely to be used regularly.

BCM policies and procedures are invoked by asset managers whenever necessary for a variety of reasons, including natural disasters (e.g., hurricanes, floods, tsunamis) and man-made events (e.g., terrorism, electrical failure). As witnessed in 2020, the COVID-19 public health crisis required the use of BCM policies and procedures to comply with public health guidance and regulations. Public health events can disrupt businesses, resulting in loss of access to facilities and systems, as well as the unavailability of personnel to perform their duties, either in their typical locations or entirely. BCM programs ensure that, even

under such situations, asset managers' business capacities continue and clients continue to be served.

Regulations require asset managers to have BCM programs to address business continuity risks. This is an integral part of prudent risk management, and many firms have programs in place that are far more comprehensive than what is legally required. It is important to recognize that having a BCM program is not analogous to having a single BCP. A BCM program allows for separate ownership of key program components and different sets of policies and procedures related to business continuity planning. As a result, procedures can be tailored to various functions within an asset management firm. For example, an operations team might maintain procedures to recover systems and data, a trading team might maintain plans to transfer trading capabilities to alternate locations or recovery sites, and a compliance team might maintain policies for notifying regulators of changes. Strong BCM practices in asset management focus on comprehensive programs that recognize the interconnectivity of distinct business units as opposed to trying to put various business continuity plans into a single box. The specifics of BCM programs necessarily vary depending on each asset manager's unique business model (e.g., product type(s), geographic focus, outsourcing of operational functions, and single location vs. multiple locations, etc.).

Given that the asset management industry is constantly changing, BCM programs are continuously evolving. As the frontier of market practices, technology, and business models in the industry shift, asset managers update their BCM programs to adequately respond to industry changes. For example, technologies facilitating greater ease of working remotely or the opening of new office locations may have significant impacts on how an asset manager considers BCM. Considering the variety of business models and circumstances, there is not – and should not – be a “one-size-fits-all” approach to BCM. Likewise, firms need to recognize that there may be a need to adapt in real-time to changing conditions during an event requiring BCM activation.

Decisions on insourcing and outsourcing

Asset managers decide which functions to complete in-house and which to outsource to a third-party vendor. Virtually all asset managers rely on third-party vendors for at least some functions. That decision reflects a combination of core expertise, control, cost, and scale. Regardless of the approach taken, asset owners managing assets internally and external asset managers need to implement clear processes with the appropriate checks and balances to ensure operational soundness throughout the investment process. The decision of which approach to take with regard to systems and vendors is specific to each asset manager. In our *ViewPoint The Role of Third Party Vendors in Asset Management*,²³ we explore the role of service providers in asset management.

As we discuss in more detail in our *ViewPoint The Role of Technology Within Asset Management*, when implementing technology systems, asset managers may choose to build a system internally, integrate multiple vendor products into a combined system, or use one centralized vendor system for the bulk of investment activities. Firms with greater technological capacities are more likely to develop, build, and maintain internal systems, whereas smaller more niche firms may choose to outsource. All models, and hybrid solutions in between, come with advantages and risks. Internal builds provide maximum control over the product or service and its implementation. The risk of outages or failures in self-built systems must be managed in house. Using third parties allows firms to benefit from specialist expertise and to scale the impact of the product or service.

Relying on multiple vendors requires data reconciliation and robust oversight processes. Relying on a fewer vendors streamlines the oversight process. However, third-party and fourth-party providers serving large proportions of clients in a market are more difficult to replace in cases of disruptions, making redundancy planning even more crucial when redundancy systems are not easily available.

There is a diverse range of services utilized by asset managers to perform numerous functions – from obtaining security data and risk analytics that inform investment decisions, to order management and trade execution systems that facilitate placing and executing trades, to accounting and performance systems and service providers that are used for reporting and recordkeeping purposes, to holding and safeguarding client assets and facilitating the settlement of transactions. Various financial market infrastructures (FMI) are essential to market participants, including exchanges, central clearing counterparties (CCPs), electronic trading and affirmation platforms, and trade messaging systems.

Third party vendors represent a diverse array of companies. Some are affiliates of banks or asset managers and others are independent firms. Some vendors have a narrow scope of offerings, while others offer comprehensive solutions to a variety of asset management business processes. All of this diversity and nuance reinforces the need to tailor appropriate oversight. **The assessment of a vendor’s business continuity management program, disaster recovery planning, critical fourth-party providers, and information security systems should be an integral part of the vendor selection and assessment process.** We recommend that asset managers have appropriate programs in place to ensure that the third parties they retain for critical operational services have sufficient controls to mitigate the risk of operational errors and that adequate business continuity and disaster recovery plans are in place. Any regulation of BCM for vendors of data, systems, or outsourcing services should be activity-based. Rules should be applied equally to all vendors with similar offerings, regardless of their organizational structure or affiliation with another organization, to reduce regulatory arbitrage in this space.

BCM is even more critical in cases where asset managers rely on a small group of irreplaceable third-party providers for certain critical services, or when one specific function is outsourced to single or a few geographic regions. As we discuss in more detail below, most firms rely on the same vendor to transmit the vast majority of shareholder reports and other regulatory documents to investors.

From a geographic perspective, many companies are reliant on functions that are concentrated in specific locations.²⁴ We recommend policymakers continue to work with asset management vendors to ensure robust business continuity management procedures are in place when operational disruptions affect a specific region. While most vendors operated smoothly during COVID-19, the crisis highlighted the importance of resilience of third-party and fourth-party service providers.

Asset management experience during COVID-19

The majority of asset management firms moved swiftly from 100% of employees working in corporate offices to almost all employees working from home in a matter of days. A key reason this transition went smoothly was the robust BCM plans at asset managers and at third party vendors that have been developed to address various potential scenarios. The transition to working remotely, underpinned by technology, allowed firms to continue servicing clients, and this resilience has been recognized by supervisors.²⁵

“ In operational terms, advisors and wealth managers responded well to the onset of the coronavirus crisis.

- Megan Butler, Executive Director of Supervision – Investment, Wholesale and Specialists, UK Financial Conduct Authority²⁶

Areas and businesses that lend themselves to digitalization faced significantly fewer challenges during COVID-19. Firms with a mobile workforce and a flexible approach towards working remotely had invested in technology prior to COVID-19 to ensure that employees could work from home (WFH). Any firm that had built up these capabilities was well-positioned when COVID-19 hit, because the groundwork had been laid for employees to work remotely full-time. For example, many firms have in place robust BCM and disaster recovery programs that regularly identify potential and ongoing threats to offices and staff around the world and require employees to undergo emergency preparedness training. In addition, many asset management firms had already implemented and tested remote access for their employees and had plans for transitions to alternative work locations (including working from home), workload transfers across employees, system failure testing, and notification systems to contact employees in the event of a disruption.

During the course of the pandemic, asset managers have further evolved and improved WFH solutions to create a more efficient experience. These challenges led to rapid innovations such as the adoption of electronic tools for document signature, expanded use of electronic collaboration tools, and acceptance across the industry for electronic rather than paper documents. In addition, firms implemented virtual desktop systems for power users of technology, such as traders and portfolio managers. This enabled individuals to access the processing power of their

firm's systems without straining their hardware and local internet connections with potentially limited bandwidth, while maintaining the oversight and accountability of in-office transactions. Virtual desktop systems have reduced dataflows significantly and reduced the strain on data infrastructure, easing the bandwidth constraints that many managers experienced during COVID-19, especially during the initial days and weeks.

Business continuity plans played an important role during COVID-19, as data infrastructure and internet access vary by location, and many employees relocated from their usual addresses to other locations. Technology developments over the last decade enabled a smoother transition than would have historically been possible, as home internet access has become commonplace in most countries and urban locations in particular. This rapid transition to a WFH environment enabled asset management firms to continue to effectively serve investors. Looking forward, the industry continues to assess potential challenges associated with a mobile workforce and evaluate return-to-office plans by jurisdiction as appropriate.

During COVID-19, some firms and functions that interact with clients on a daily basis faced challenges. Call centers were particularly stressed during the initial phases of COVID-19, as redirecting calls to cell phones presented challenges, given that a cellphone does not have the same capabilities as a call center and, in many cases, firms had to physically provide phones for employees. In addition, when calls occur on cell phones rather than landlines, firms are required to rely on cell service providers to provide recorded lines rather than being able to record calls directly. Acknowledging this, regulators issued relief during the initial phase of COVID-19 to allow firms to address these issues. The CFTC issued no-action letters giving firms until June 30, 2020 to leverage technology and to find workable solutions for their call-monitoring procedures.²⁷ The FCA indicated in a statement its willingness to discuss individual issues with firms and to refrain from enforcement where appropriate.²⁸

While asset management firms have continued to demonstrate resilience during COVID-19, some firms and services that asset managers rely on were challenged during the stressed market environment. Some firms faced challenges directly, while others experienced issues because of disruptions further down the line at the level of fourth party service providers. It is essential to consider third- and fourth-party dependencies in any BCM framework. While an asset manager may not have granularity on fourth party service providers, robust and formal governance around third party providers can help identify and mitigate issues. Third party vendors should outline the capabilities and oversight of vendors they rely on.

Case Study: Pricing services

Due to the stressed market environment in March 2020, there was a lag in pricing information for certain securities. Deloitte recently released their annual Fair Valuation Pricing Survey of over 100 registered investment company fund groups.²⁹ 65% of participants reported that during the pandemic, they found a security price from their primary pricing source unreliable, resulting in a need to utilize a second pricing source or use an internal model. 56% reported that prices from an external pricing source were unsupported by transaction prices.³⁰ As markets experienced increased volatility, trading in certain bonds froze, and certain foreign equity exchanges suspended trading, it became challenging for pricing service providers to deliver information at the same speed as markets moved.

For example, certain bonds lacked trading information. In normal conditions, fewer than 1% of more than 21,000 publicly registered corporate bonds trade daily in the over-the-counter market.³¹ Bond prices can be estimated based on the last time a bond traded, as well as based on trades of similar bonds (e.g., from the same issuer or in the same sector). When markets froze and bonds stopped trading in March, the available information no longer reflected prices that market participants were willing to accept. This lag created an imbalance between where the bonds should have been priced at a moment in time and where they were priced based on the last available information. Difficulties with price formation and unusual price developments also occurred in other asset classes, including real estate investments.³²

Asset managers rely on pricing vendors to provide accurate prices of bonds and other securities, and the COVID-19 environment underscored the importance of BCM oversight of pricing providers. There should be clear oversight of these pricing providers by both regulators and the firms that contract with them. In situations where a security price is clearly inaccurate, an asset manager can challenge the vendor's price and, where appropriate, make a fair-value determination to override the price.

Despite the challenges faced during COVID-19, funds were generally able to continue to strike and publish NAVs throughout the pandemic as firms were able to leverage technology and make real-time adjustments, including to control processes.³³ In addition, when bond prices were challenged, bond ETFs provided price discovery for investors. For more information on bond ETFs, see BlackRock's *ViewPoint* titled [Lessons from COVID-19: ETFs as a Source of Stability](#).³⁴

Case Study: Delivery of shareholder documents in the US

COVID-19 highlighted the value to end investors of allowing electronic delivery as the default delivery mechanism for regulatory documents. During COVID-19, print vendors and suppliers that the asset management industry relies on to produce and transmit fund documents faced challenges as a result of federal, state, and local orders and ordinances, as well as issues with the US Postal Service, which in some cases resulted in production issues and significant mail delays. While some jurisdictions permit electronic delivery as the default mechanism for delivering regulatory documents, the US only does so on a limited basis. In June 2018, the SEC adopted rule 30e-3, which allows funds an optional method to transmit shareholder reports electronically.³⁵ In contrast, other regulatory documents, including mutual fund prospectuses, must be delivered via paper as the default mechanism. The asset management industry has recommended that the SEC expand the use of electronic delivery as the permitted default for all regulatory fund documents.³⁶ Allowing broader use of electronic delivery would better align with investor preferences to receive documents digitally and mitigate the risk of challenges with paper delivery experienced during COVID-19.

A related issue is the concentration with a single vendor to disseminate shareholder reports and account statements. A significant portion of broker-distributed mutual fund assets are held in omnibus accounts, where an intermediary is the record owner and the mutual fund relies on the intermediary to deliver fund materials to the underlying shareholders. Intermediaries generally outsource document delivery, including both paper and electronic delivery, to one predominant vendor, who then charges the mutual fund for delivery fees. To mitigate third party concentration risk, the asset management industry has called for the SEC to encourage greater competition in vendor selection.³⁷

Two areas that experienced disruptions during COVID-19 were pricing services and the delivery of shareholder documents (see case studies on page 7). Asset managers generally rely on third party vendors for both services.

The unusual market volatility and a decrease in trading of certain securities created challenges for pricing service providers, who were, in some cases, unable to deliver accurate pricing information in real time. We encourage regulators to work with these vendors to ensure robust BCM, including processes regarding reaction time and reliability, especially as due diligence practices continue to evolve to reflect a more virtual environment.

The COVID-19 crisis highlighted the importance of electronic communication. In the US, many shareholder documents are required to be delivered via physical mail.

During the pandemic, there were processing and mail delays that prevented these documents from being delivered in a timely manner. To prevent this type of disruption and address investor preferences for electronic delivery of financial documents, several asset managers have recommended that the SEC expand the use of electronic delivery as the permitted default for all regulatory fund documents.³⁸

Policy makers around the globe have identified operational risk as a critical component of financial stability during COVID-19. Some regulators have acknowledged the significant role of third-party service providers and many have recognized that the asset management industry and markets functioned well. Exhibit 2 reflects views that have been expressed by various regulators related to the COVID-19 Crisis.

Exhibit 2: Highlights from 2020 Official Sector Reports

Bank of England - The Bank of England, Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA) have published a shared policy summary and coordinated consultation papers (CPs) on new requirements to strengthen operational resilience in the financial services sector.³⁹ The papers do not propose changing the rules for reliance on third party service providers; rather, they reiterate the supervisory expectation to view resilience through the lens of the impact to end investors. They note that all firms remain responsible for the management of their outsourcing and third-party relationships.

European Commission - The European Commission (EC) has been consulting on digital operational resilience in 2019,⁴⁰ stressing the importance of resilient infrastructure for functioning financial markets in Europe. Based on this consultation, the EC published a legislative proposal including far reaching requirements for financial institutions using third party vendors and investigative powers for national and European supervisors over unregulated providers of services.⁴¹ The scope of the proposals is currently broad and allows significant supervisory discretion. The decisions on the final rules will be taken between the European Parliament and the European Commission.

Federal Reserve - In its May 2020 Financial Stability Report,⁴² the Federal Reserve highlighted that amid the pandemic, many “financial institutions are at a greater risk for adverse operational events.” They highlighted that many firms are operating on business continuity plans, while intermediating high volumes and weathering additional challenges related to WFH, illness, and childcare. The report also noted that vulnerabilities to security risks were heightened during COVID-19. The Federal Reserve noted that the relative success thus far demonstrates the benefits of both having BCPs and actively testing them.

Financial Stability Board (FSB) - In their July 2020 report to the G20,⁴³ the FSB highlighted the functioning of financial markets infrastructures, especially CCPs. In its April 2020 report titled “FSB Principles that underpin the official sector response to the pandemic,” the FSB highlighted commitments by official sector players to reduce operational burdens on firms and authorities as they respond directly to the COVID-19-related economic crisis.⁴⁴ The FSB has also pointed out potential financial stability implications of third-party dependencies in cloud services.⁴⁵

Securities and Exchange Commission (SEC) - In remarks to the Financial Stability Oversight Council (FSOC), SEC Chairman Jay Clayton underscored that the “pipes and plumbing” of markets “functioned largely as designed, and...as expect[ed]” despite extraordinary volumes and volatility during the pandemic. He noted that he observed “no systemically adverse operational issues” in key market infrastructure.⁴⁶

Recommendations to enhance operational resilience

As policy makers look to strengthen the operational resilience of asset managers and the vendors upon which they rely, we offer several principles for consideration to enhance BCM and ensure robust risk management.

- **Balance the need for minimum BCM standards with the need for flexibility to tailor BCM policies and procedures to each firm’s unique business model and each jurisdiction’s particularities.** Different regions face different risks and have different regulatory requirements. For example, some countries have different oversight requirements for interactions with clients and external parties.
- **The diversity of asset management business models warrants that each asset manager has a BCM program, including one or more BCPs that address, at a minimum, the following:**
 - i. Documentation of critical work and the business impact of that work not being completed;
 - ii. Maintenance of critical operations and systems, and protections to back-up and recover data;
 - iii. Communications with clients, employees, service providers, and regulators; and
 - iv. Identification and assessment of third-party services critical to the operation of the asset manager.

Asset managers should have flexibility to implement these principles. The implementation of each point above may vary from manager to manager and should be tailored to the business model, size, scale, criticality of operations, and geographic location(s) of the firm and its clients.
- **Practicing good vendor management, including ongoing due diligence of the BCM programs of third-party service providers.** Asset managers should discuss BCM programs with service providers, and the extent of

back-up arrangements should be proportional to the materiality of a service provider to an asset manager’s business. For example, in asset management, a bank that custodies client assets provides a critical service that warrants robust oversight.

- **Asset managers should have BCM programs that include testing of technology and testing of crisis management response capabilities, including disaster recovery plans.** In cases where asset managers outsource functions or technology, they should ensure adequate testing is taking place at the third-party service provider.
- **Asset managers should conduct annual reviews of their BCM programs** to ensure these programs remain up to date and reflect the current market and technological environment. In addition, firms and regulators should create flexible plans that allow them, to the best of their abilities, to adapt and respond to unprecedented events beyond the expected scope of disruption.⁴⁷
- **BCM program documents should not be made public nor subject to filing requirements.** Individual BCPs and overall BCM frameworks should be treated confidentially as (i) they contain details about a firm’s business operations that could be used to support illicit behavior such as cyber-crime, (ii) they contain personally identifying information (PII) of the firm’s staff, and (iii) these documents need to be kept up to date, which requires frequent changes. Filing BCM policies and procedures would not serve any regulatory utility and would impose significant costs.
- **Asset managers should consider how BCM plans, disaster recovery plans, and operational resilience may need to evolve looking forward.** As firms consider a more mobile workforce with WFH capabilities and/or return to office plans, they should revisit their BCM programs to account for what operational resilience looks like in this new environment.

Related publications

- [Letter to the SEC Re: Adviser Business Continuity and Transition Plans](#)
- [ViewPoint – The Role of Third Party Vendors in Asset Management](#)
- [Remarks by Barbara Novick at the Cumberland Lodge Financial Services Summit – The Future for Financial Services](#)
- [ViewPoint – The Role of Technology Within Asset Management](#)

Endnotes

1. Barbara Novick, Remarks at the Cumberland Lodge Financial Services Summit on The Future for Financial Services (November 9, 2017), available at <https://www.blackrock.com/corporate/literature/publication/barbara-novick-remarks-cumberland-financial-services-summit-technology-110917.pdf>.
2. Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities: <https://www.fsb.org/wp-content/uploads/FSB-Policy-Recommendations-on-Asset-Management-Structural-Vulnerabilities.pdf>
3. The German minimum standards KAMaRisk are based on level II legislation implementing the European Alternative Investment Funds Directive (AIFMD) <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32013R0231> and are applicable to all fund managers under German law. In the UK, the minimum standards for risk management are defined in chapter COLL 6.12 in the regulatory handbook for collective investment undertakings. <https://www.handbook.fca.org.uk/handbook/COLL/6/12.html> The requirements applicable to all management companies are also more detailed than what is required by the UCITS framework.
4. SEC, Division of Investment Management, Guidance Update, Business Continuity Planning for Registered Investment Companies (June 2016), available at <https://www.sec.gov/investment/im-guidance-2016-04.pdf>.
5. Australia Federal Register of Legislation, Corporations Act 2001, available at <https://www.legislation.gov.au/Details/C2018C00424>.
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