

## BC/DR Testing Under Regulation SCI

### FINRA Publishes Consolidated Criteria to Designate Firms for Mandatory Participation in FINRA's Business Continuity/Disaster Recovery Testing

#### Summary

As required by SEC Regulation Systems Compliance and Integrity (Regulation SCI), FINRA in 2015 adopted Rule 4380 requiring member firm participation in business continuity and disaster recovery (BC/DR) testing.<sup>1</sup> The rule authorizes FINRA to designate firms that must participate in FINRA's annual BC/DR test based on established standards, which FINRA first published in *Regulatory Notice 15-43* and updated in *Regulatory Notice 18-09*. This *Notice* consolidates FINRA's designation criteria, as previously announced in *Notices 15-43* and *18-09*, without change.

Questions regarding this *Notice* should be directed to:

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#### Background and Discussion

Regulation SCI requires that FINRA, as an SCI entity, establish, maintain and enforce written policies and procedures that address, among other things, "[b]usiness continuity and disaster recovery plans that include maintaining backup and recovery capabilities sufficiently resilient and geographically diverse..."<sup>2</sup> In addition, Regulation SCI requires each SCI entity, including FINRA, to designate firms that must participate in the testing of the entity's BC/DR plans.<sup>3</sup>

April 19, 2019

#### Notice Type

- ▶ Guidance

#### Suggested Routing

- ▶ Compliance
- ▶ Legal
- ▶ Operations
- ▶ Risk Management Committee
- ▶ Systems
- ▶ Trading
- ▶ Training

#### Key Topics

- ▶ Business Continuity
- ▶ Disaster Recovery Planning
- ▶ Regulation SCI

#### Referenced Rules & Notices

- ▶ FINRA Rule 4380
- ▶ FINRA Rule 6710
- ▶ SEC Rule 1001
- ▶ SEC Rule 1004
- ▶ Regulatory Notice 18-09
- ▶ Regulatory Notice 15-43

To comply with these Regulation SCI requirements, FINRA adopted Rule 4380 in 2015. The rule authorizes FINRA to designate member firms that must participate in annual BC/DR testing according to established criteria designed to ensure participation by firms FINRA reasonably determines are, taken as a whole, the minimum necessary for maintaining fair and orderly markets in the event of the activation of its BC/DR plan.

## Consolidated Designation Criteria

As announced in *Regulatory Notices 15-43* and *18-09*, FINRA applies the following criteria to designate firms under Rule 4380:

- ▶ For the **FINRA TRFs**,<sup>4</sup> FINRA will designate those TRF participants<sup>5</sup> that account for 5 percent or more of the total number of trades reported to the TRF over the six-month period immediately preceding designation, provided that the cumulative trade volume represented by designated firms amounts to at least 50 percent of all trade volume reported to the TRF during the applicable six-month period.
- ▶ For **ORF**, FINRA will designate participants that account for at least 5 percent or more of the total number of trades reported to ORF over the six-month period immediately preceding designation, provided that the cumulative trade volume represented by designated firms amounts to at least 50 percent of all trade volume reported to ORF during the applicable six-month period.
- ▶ For **TRACE** (not including TRACE for Treasuries), FINRA will designate participants that account for at least 5 percent or more of the average dollar volume in either: (1) corporate and Agency Debt Securities, or (2) Securitized Products,<sup>6</sup> over the six-month period immediately preceding designation, provided that the cumulative dollar volume represented by designated firms amounts to at least 50 percent of all dollar volume reported to TRACE during the applicable six month period.
- ▶ For **TRACE for Treasuries**, FINRA will designate participants that account for at least 5 percent or more of the average dollar volume over the six-month period immediately preceding designation, provided that the cumulative dollar volume represented by designated firms amounts to at least 50 percent of all dollar volume in Treasury securities reported to TRACE during the applicable six-month period.
- ▶ For **OATS**, FINRA will designate firms that account for at least 5 percent or more of OATS Reportable Order Event records (ROEs) over the six-month period immediately preceding the designation, provided that the cumulative activity represented by designated firms amounts to at least 50 percent of all ROEs reported to OATS during the applicable six-month period.
- ▶ For the **ADF**, there currently are not any active participants. If the ADF becomes active, FINRA will then study the system's activity to establish appropriate criteria for member designation.

- ▶ For the **OTCBB**, FINRA will designate participants that account for at least 20 positions in OTCBB symbols per day on the OTCBB during the applicable six-month period, provided that the cumulative quoting represented by designated firms amounts to at least 50 percent of all quoting on the OTCBB during the applicable six-month period.

As noted above, FINRA is consolidating these criteria from *Notices 15-43* and *18-09* here in this *Notice* without change. FINRA will notify firms that meet these criteria individually by email in or around April of each year. FINRA will include in the notification email the date of the annual test, which typically is in October of each year; information about the voluntary connectivity pre-test, which typically occurs several weeks before the annual test date; and the contact information for FINRA staff that coordinates testing activity.

## Results of Designation and Voluntary Test Participation

For consolidated reference, FINRA is also repeating here without change the discussion in *Regulatory Notice 15-43* of the designation process and test-related guidance.

Rule 4380(c) states the obligations of member firms that are designated for mandatory participation in FINRA's BC/DR testing according to the standards specified above. Specifically, designated firms would be required to fulfill, within the time frames established by FINRA, certain testing requirements that FINRA determines are necessary and appropriate. These requirements could include, for example, bringing up their systems on the designated testing day and processing test scripts to simulate trading activity. Designated firms may also be required to satisfy related reporting requirements; for example, reporting the firm's testing results, so that FINRA may evaluate the efficacy of the test and, correspondingly, its BC/DR plan.<sup>7</sup>

FINRA recognizes there may be market participants that wish to participate on a voluntary basis in FINRA's annual BC/DR test beyond those that are designated under Rule 4380. For example, certain system participants may wish to test their backup capabilities even if they do not exceed the system's threshold cutoff. Additionally, third-party service providers, like service bureaus that transmit information to FINRA systems on behalf of FINRA member firms, may also wish to ensure their ability to function in FINRA's backup environment, even though the service providers may not be subject to Rule 4380. FINRA encourages any such market participant to contact FINRA Product Management at (866) 899-2107 or Market Operations at (866) 776-0800 to consider arrangements to take part in FINRA's testing.

1. See Securities Exchange Act Release No. 76360 (November 5, 2015), 80 FR 70043 (November 12, 2015) (Notice of Filing and Immediate Effectiveness of SR-FINRA-2015-046).
2. SEC Rule 1001(a)(2)(v).
3. SEC Rule 1004.
4. Today, there are three Trade Reporting Facilities (TRFs) in operation: FINRA/Nasdaq TRF Carteret, FINRA/Nasdaq TRF Chicago and FINRA/NYSE TRF. Trade volume for purposes of Rule 4380 is separately calculated for each TRF.
5. Consistent with *Regulatory Notice 15-43*, FINRA calculates participant activity at the Member Participant Identifier (MPID) level and designates the parent firm of any MPID that meets or exceeds a stated threshold. If FINRA encounters a situation where a parent firm represents significant volume on a system through multiple MPIDs—none of which individually meet or exceed the system’s stated threshold—FINRA may in its discretion designate the member based on its overall activity on the system.
6. The terms “Agency Debt Security” and “Securitized Product” are defined in Rule 6710.
7. As FINRA noted when it filed Rule 4380, compliance with the rule may be enforced consistent with existing FINRA rules and practice, and a designated firm’s failure to participate in mandatory testing could result in possible sanctions, including fines, under FINRA Rule 8310.