

TESTIMONY OF
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**"RECOVERY AND RENEWAL: PROTECTING THE CAPITAL MARKETS
AGAINST TERRORISM POST 9/11"**

BEFORE THE
Capital Markets, Insurance and Government Sponsored Enterprises
Subcommittee of the House Financial Services Committee

February 12, 2003

Subcommittee Chairman Baker and Members of the Committee:

I am Don Kittell, Executive Vice President of the Securities Industry Association.¹ I am pleased to appear before the Committee on behalf of SIA to testify about the business continuity planning (BCP) efforts of the securities industry. I applaud the Committee for its timely discussion of business continuity planning in a post 9/11 environment.

I am proud of the leadership role securities firms have taken through SIA to ensure our industry is better prepared to recover from future disasters. I especially applaud the work of the SIA Business Continuity Planning Committee to engage with securities exchanges, clearance and settlement organizations, service providers, financial services associations, state and local government and federal regulators to develop a comprehensive approach toward business continuity planning.

Since 9/11, we have thought very differently about business continuity planning. The safety and security we all assumed we had just doesn't exist anymore. And disaster is no longer limited to a single building, single utility, or single market being down, but now includes the possibility of multiple buildings and entire geographic areas being devastated. Our industry is now in the midst of creating a systemic approach that covers a broader array of contingencies. And we must do all of this while we are managing in a tighter business environment. Indeed, we must find the most effective means of preserving the safety and security of our financial system without incurring overwhelming or unnecessary costs.

The War on Terrorism Is A National Priority

We have all had to absorb the implications of the war on terrorism – of 9/11, the war in Afghanistan, the instability of Pakistan, the insolvable conflict between the Israelis and the Palestinians, and now a potential war in Iraq and the uncertainty of its possible consequences in the Middle East and on oil prices. Perhaps the most significant outcome of the 9/11 attacks was the realization that the United States does not live in isolation, safe from terrorism in other parts of the world.

What has been the impact of that realization on the equity market?

We now know that there is danger at home. Our assumption is that additional attacks will happen.

Industry infrastructure is being dispersed to minimize single points of failure. Exchanges, clearance and settlement organizations, telecommunication companies, and clearing banks are investing in backup facilities.

Following 9/11, disaster recovery became recognized as the responsibility of all business units, not just I/T or operations.

Industry command centers are now in place and they are linked with other centers in municipal, state and federal government, as well as to other industry sectors such as telecommunications and transportation.

We cannot say we can defend against any and all attacks. But we can say we better understand the threat and have taken significant steps to prevent them from happening in the first place, and to recover from them once they do happen.

SIA Business Continuity Planning Effort

SIA Business Continuity Planning Committee (BCP Committee)

In December 2001, SIA formed a BCP Committee by incorporating a pre-existing, informal industry forum known as the Securities Industry Business Continuity Management Group. The Committee's mission is to:

Provide a forum for securities firms, industry organizations, and service providers to share specific plans and business continuity information;

Identify and develop business continuity plans and projects that have an industry-wide, rather than a firm-specific, focus; and,

Provide a liaison between the securities industry and government legislators, regulators, and service providers, as well as to related industries such as telecommunications and power utilities.

The Committee also has seven subcommittees: Command Center; Exchange/Markets, Utilities & Service Providers; Industry Testing; Critical Infrastructure Planning & Urban Renewal; Best Practices; Insurance; and Catastrophic Events.

SIA BCP Committee Accomplishments

Through the seven subcommittees of the SIA BCP Committee, much has been accomplished, including:

Issuing a lessons learned document, which is a collection of observations and experiences from those involved in ensuring business continuity (document available at www.sia.com);

Producing Best Practices Guidelines (document available at www.sia.com), which recommend a Business Continuity Program, recovery strategies and recovery resources;

Creating an industry command center with an established course of action plan. This center manages events impacting industry-wide operations. The command center links securities firms, exchanges and utilities, the New York City Office of Emergency Management and federal and state regulatory agencies. Physical and virtual facilities and communications links and contact lists are all in place. The first successful test of the command center was completed in May 2002;

Developing a plan for industry testing (document available at www.sia.com) to confirm major institutions, exchanges and industry utilities could simultaneously activate work area recovery and data center recovery plans from alternate sites. This initiative worked to increase the confidence level within the industry and in the investing public's view, to satisfy regulators that the industry can quickly recover from a widespread outage with minimal disruption to the financial markets;

Presenting to the Lower Manhattan Development Corporation (document available at www.sia.com) recommendations on ensuring the financial community's concerns, especially as they relate to life safety, security, disaster preparedness and business continuity, are addressed in the redevelopment efforts of the World Trade Center site and surrounding areas; and,

Providing the industry with education and awareness through the SIA website and conducting the first SIA BCP Conference this past October, with a strong program of public and private sector experts and approximately 350 attendees.

SIA BCP Committee Continuing Work

In addition, the SIA BCP Committee continues to work on further testing to confirm that major institutions, exchanges and industry utilities can simultaneously activate work area recovery and data center recovery plans from alternate sites. These efforts will increase the confidence level within the industry and in the investing public's view and to satisfy regulators that the industry can quickly recover from a widespread outage with minimal disruption to the financial markets. The committee is also expanding the scope of testing already underway via the SIA BCP Command Center, and developing and planning a course of action for specific catastrophic events using scenario planning. During this process the committee is working with major utility providers including telecommunications, power and water, and major industry vendors to determine and develop better ways to protect the industry. To that vein, the Committee is preparing to release a recently developed survey for service providers (available at www.sia.com).

Government and Private Sector Involvement

The SIA BCP Committee also continues to be an active participant in the newly formed Financial Services Sector Coordinating Council for critical infrastructure protection and homeland security (FSSCC). This private sector group was formed at the request of the US Treasury, which is chairing the Financial and Banking Information Infrastructure Committee (FBIIC). The FBIIC coordinates the protection, security and recovery efforts of 15 federal regulatory agencies.

The primary objective of FSSCC is to communicate between the private and federal regulatory sectors on business continuity issues. An organization established as the Financial Services Information Sharing and Analysis Center (FS/ISAC) will assist FSSCC in its mission. The FS/ISAC is one of eight industry-sector ISACs established by presidential decision directive. The other seven sectors include government services, electric power, emergency services, oil and gas, water, telecommunications and transportation.

SIA Benchmark Survey

The prodigious amount of work committed to planning is borne out by the results of a recently conducted SIA Business Continuity Planning Benchmarking Survey. The survey was designed to give BCP professionals in the financial sector a snapshot on what other firms were doing with their recovery programs. The survey found that additional reporting lines for business continuity had been added at the very top levels of the organizations and that the top priorities are people recovery, technology recovery and program assumptions. The survey also found that testing is an important priority. The survey shows that since September 11, personnel relocation changes have become further diversified with some firms moving further from their primary site, some diversifying their recovery locations, some firms separating their people from technology, and some firms opting for other solutions. Also, the survey shows that since September 11, all aspects of firms' BCP programs have been thoroughly reviewed and many scenario assumptions have changed (i.e., from single building/small incident to multiple buildings/large area).

GAO Report: POTENTIAL TERRORIST ATTACKS, Additional Actions

Needed to Better Prepare Critical Financial Market Participants

The SIA BCP Committee looks forward to a complete and thorough review of the newly released GAO study "Potential Terrorist Attacks: Additional Actions Needed to Better Prepare Critical Financial Market Participants" (GAO 03-251). After a preliminary reading of the study, SIA agrees with the findings to identify strategies for recovery, determine the sound practices needed to implement these strategies, and identify the organizations that would conduct trading under these strategies. In the post 9/11 environment, the broker-dealer community has been working diligently, both as individual firms and collectively through the Associations, on the issue of business continuity planning, as suggested by the report. The tragic events of September 11 exposed vulnerabilities in business continuity plans, which firms undertook to address immediately. That resolve would have existed independent of regulatory pressure because of the strong commitment the securities industry has to its customers and the competitive pressure that exists for firms to prepare for disruptions, including the demands of customers and counterparties and other interdependent entities. We feel strongly that a joint effort on the part of the

industry and its regulators is a better approach to mitigate the risk involved for sound business practices. We stand by our comments to the agencies on business continuity and do not believe a "one size fits all" scenario is feasible. SIA and its BCP Committee look forward to continuing work with its regulators.

Joint SIA and TBMA Dialogue with Regulators

NYSE and NASD Proposed Rules

In September 2002, the Associations (SIA and TBMA) responded to rule proposals of the New York Stock Exchange (NYSE) and the National Association of Securities Dealers (NASD) relating to business continuity and contingency planning. In their letter, the Associations expressed their support for the approach of requiring members to maintain auditable, updated plans that established the firms' procedures to be followed in the event of a significant disruption. Moreover, the NASD and the NYSE chose to identify the elements of continuity that plans should address – alternate physical location of firm and its employees, books and records back-up, alternate means of communication, etc. – rather than mandate what the plan ought to be. In fact, the theme that features prominently in both proposals is that plans should reflect the diverse nature of the member-firm community and thus, the proposed rule ought to allow member firms to tailor plans to suit their, size, business, and structure.

Inter Agency White Paper

In October 2002, the SIA and the Bond Market Association (TBMA) again jointly responded to the proposed Interagency White Paper on "Sound Practices to Strengthen the Resilience of the U.S. Financial System." The associations applauded the excellent cooperation exhibited by the agencies in soliciting the views of our member firms and preparing guidance for business continuity planning. However, we strongly recommended that these cooperative efforts continue, particularly if the ultimate goal is publication of supervisory expectations or another form of guidance. Because firms create business continuity plans for the entire enterprise, it is critical that guidance be consistent for separately regulated entities of the same financial institution.

We respect the need of the agencies to be assured that critical financial markets and core and significant participants are studying the risks and planning accordingly. As the Interagency White Paper notes, the resilience of the financial system is only as strong as its weakest link and good planning will still require regulators to ensure that all parties, including core and significant firms and critical financial (exchanges, utilities, etc.) and non-financial (telecommunications, government, etc.) entities participate in this effort. The Associations support identifying the processes and functions such as value transfers and pending transactions, as well as funding and posting of collateral that are deemed essential to recovery. The Associations also believe it is appropriate for the agencies to distinguish core and significant participants, although it will be just as important for the regulators to be sensitive to language that may be used to equate critical with capable, and thereby hurt the interests of many robust, smaller firms.

Beyond ensuring that core and significant firms have updated plans that address certain basic elements of continuity for critical processes elements of continuity in critical areas, we believe it

is difficult, if not impossible, for the agencies to describe either the risks that an individual firm ought to consider or the means (or practices) that the firm ought to use to manage them. The Associations are concerned that some of the ideas presented in the White Paper go beyond illustrative examples and are intended to bind firms to a specific scenario and a specific plan or plan element. As the White Paper notes, firms feel strongly that "one size does not fit all." For example in specifying the base line event for planning as a "wide-scale regional disruption," and suggesting that there exists an industry consensus around a sound practice of planning for separate labor pools, the White Paper makes questionable assumptions and conclusions that could limit the approaches that a firm might consider in light of its assessment of risk and the demands of its customers and the interdependent participants in its industry.

Many of our comments stem from a concern that since the agencies involved are also regulators, some of the more specific recommendations contained in the White Paper could have unintended legal authority and set unnecessary standards. Moreover, many of the questions posed in the Request for Comment section seem aimed at the possibility of developing more specific guidance, which the Associations feel will apply a "one size fits all" approach for a diverse group of firms. The results of firms' planning efforts are always available for inspection by the appropriate examining authorities, who can determine whether the specific elements of any plan address the general goals and principles laid out by the agencies.

Finally, the agencies should evaluate the impact of the guidance on competition in low-margin businesses like clearing. To the degree that the White Paper includes guidance that limits a core or significant firm's ability to implement cost-efficient solutions, some firms may decide not to continue in the business. This has important repercussions for end-user firms, the competitiveness of the business vis-à-vis foreign providers of these same services, and the concentration of risk within the industry.

SIA believes the White Paper can be most effective as a means of identifying the factors that core and significant firms need to address in business continuity planning without mandating what these plans ought to be. To the degree that specific scenarios and practices are included in the White Paper, they should be presented in context as part of a survey of non-binding, non-exclusive examples observed by the agencies. Finally, we believe that the interdependent nature of our industry requires that the agencies be vigilant with respect to the continuity planning of financial and non-financial entities, such as exchanges and power companies. The status of these interdependent entities will influence the success of the firms' own efforts.

CONCLUSION

The lessons we have learned from the terrorist attack on 9/11 will produce significant benefits to the industry. These lessons are hard. And there are legitimate concerns that some of the proposed reforms cause more problems than they solve. But, on balance, the benefits will be significant. And we will all be better off because of them.

Managing business continuity risk is not just a priority for financial institutions; it is at the core of the services that they sell to the public. For this reason, financial institutions are especially qualified to successfully identify and manage this risk.

Mr. Chairman, SIA appreciates the opportunity to share our views with you this afternoon. We hope that our comments are helpful and we look forward to a continuation of the constructive dialogue that has helped focus our members' business continuity planning efforts.

Thank you.

¹The Securities Industry Association brings together the shared interests of more than 600 securities firms to accomplish common goals. SIA member-firms (including investment banks, broker-dealers, and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. Collectively they employ more than 495,000 individuals, representing 97 percent of total employment in securities brokers and dealers. The U.S. securities industry manages the accounts of nearly 93-million investors directly and indirectly through corporate, thrift, and pension plans. In 2001, the industry generated \$280 billion in U.S. revenue and \$383 billion in global revenues