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SUPPLEMENTARY INFORMATION:

I. Background

A critical “lesson learned” from the events of September 11, 2001 is the need for more rigorous business continuity planning in the financial sector to address problems of wider geographic scope and longer duration than those previously addressed. These events made clear the possibility of a large-scale regional disaster, resulting in a broad consensus in the financial community that business continuity planning needs to adapt to plan for events of wider scope and, in general, become more robust and resilient. Since the September 11 attacks, the U.S. securities markets and market participants have taken significant steps toward this goal by demonstrably improving the robustness of their business continuity plans.

The Commission and other financial regulators also have been devoting substantial resources to efforts designed to strengthen the resilience of the financial sector. For example, the Commission, together with the Board of Governors of the Federal Reserve System and the Office of the Comptroller of the Currency, recently published an Interagency Paper on Sound Practices to Strengthen the Resilience of the U.S. Financial System (Interagency Paper),¹ that identified “sound practices” relating to business continuity planning for certain key market participants. The goal of this project was to minimize the immediate systemic effects of a wide-scale disruption by assuring that the key payment and settlement systems could resume operation promptly following a wide-scale disaster, and major participants in those systems could recover sufficiently to complete pending transactions. In this way, market participants unaffected by the disaster could continue to operate with minimal disruption and, when those impacted by the event were in a position to resume

operations, the critical infrastructure would be available for them to do so. The sound practices identified by the Interagency Paper include: (1) Intraday resumption or recovery goals; (2) maintenance of sufficient geographically dispersed resources to meet those goals; and (3) routine testing of business continuity arrangements. The Interagency Paper, however, focuses only on the key payment and settlement systems, and does not address the resilience of the trading markets.

Separately, Commission staff has been reviewing, on an ongoing basis, the efforts of the organized securities markets—the exchanges, Nasdaq, and ECNs—to strengthen their resilience in the post-September 11 environment. To date, these markets have taken a variety of steps to improve their physical security, information system protections, and business continuity capabilities. For example, the New York Stock Exchange (NYSE) has taken substantial measures to physically secure its Wall Street trading floor, and has established an off-site alternative trading floor that could be activated on a next-day basis if the NYSE’s Wall Street trading floor was rendered inaccessible. Commission staff continues to work with the organized markets to further increase the robustness of their individual plans. In addition, Commission staff has been exploring with the markets the possibility of mutual back-up arrangements. For example, at the staff’s urging, the NYSE and Nasdaq have agreed to serve as back-up trading platforms for each other’s securities if a catastrophic event forced an extended closure of one market.

Earlier this year, the Government Accounting Office (GAO) issued a Report² recommending, among other things, that the Commission work with the securities industry to develop goals and strategies to resume trading in securities as rapidly as appropriate in the event of future disruptions, and determine sound business continuity practices that organizations would need to meet these goals. The Commission agreed with the GAO that more needs to be done to prepare the securities markets for the resumption of trading in the event of a crisis, and indicated an intent to consider identifying a time frame against which markets should plan to resume trading following a

wide-scale regional disaster.³ By establishing a specific resumption goal, the Commission would provide the securities markets with a consistent benchmark to use in developing more resilient business continuity plans.

II. Policy Statement

In view of the importance of the trading markets to the U.S. financial system, the Commission believes it appropriate⁴ for the SRO Markets and ECNs to prepare for the resumption of trading in the event of a “wide-scale disruption.”⁵ Among other things, the trading markets provide the means for financial institutions to adjust their cash and securities positions, and those of their customers, in order to effectively manage liquidity, market, and other risks. These markets also are critical to the capital raising process and for funding daily business operations. With over half of all U.S. households invested in the capital markets, the mechanisms for managing and valuing that wealth—the trading markets—must be highly-resilient.

That said, while there is little doubt that the trading markets collectively are critical to the U.S. financial system, the Commission is of the view that, individually, the markets present a lesser degree of systemic vulnerability than the key clearance and settlement utilities. For one, trading activity is relatively fungible across markets. In today’s diverse U.S. national market system, very few securities are traded only in one market. As a result, the Commission believes that, were any single securities market to become incapacitated, trading could be shifted to one or more of the remaining markets. Accordingly, the business continuity planning principles for individual trading markets, set forth below, are somewhat less stringent than the sound

³ See Testimony of Robert L.D. Colby, Deputy Director, Division of Market Regulation, U.S. Securities and Exchange Commission, at Hearing Before the House Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises, Committee on Financial Services, entitled *Recovery and Renewal: Protecting the Capital Markets Against Terrorism Post 9/11* (February 12, 2003).

⁴ Among other things, the Commission believes that the Policy Statement is consistent with and in furtherance of sections 2 and 11A (a) (1) (B) and (C) of the Securities Exchange Act of 1934.

⁵ The term “wide-scale disruption” has the same meaning here as in the Interagency Paper. Specifically, a “wide-scale disruption” is an event that causes a severe disruption or destruction of transportation, telecommunications, power, or other critical infrastructure components across a metropolitan or other geographic area and the adjacent communities that are economically integrated with it; or that results in a wide-scale evacuation or inaccessibility of the population within normal commuting range of the disruption’s origin.

¹ Interagency Paper on Sound Practices to Strengthen the Resilience of the U.S. Financial System, SEC Release No. 34-47638 (April 7, 2003).

² Report to Congressional Requesters of the United States General Accounting Office entitled *Potential Terrorist Attacks: Additional Actions Would Better Prepare Critical Financial Market Participants* (February 12, 2003).