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REGULATORY EXPECTATIONS FOR CYBERSECURITY PRACTICES AT BROKER-DEALERS

As the number of data breaches has grown rapidly in recent years, cybersecurity has become an increasingly important priority for broker-dealer regulators. The authors address this subject in detail, focusing on SEC and FINRA rules, regulations, and extensive guidance. They then turn to the lessons to be drawn from the law and guidance and conclude with a discussion of SEC and FINRA enforcement actions arising from cybersecurity failures and the lessons to be drawn from those cases.

By Daniel Nathan, Heather Sussman and Colleen Hespeler *

Securities brokers have not been immune from the data breaches that have afflicted so many industries over the last 15 years or so, and consequently broker-dealer regulators have made cybersecurity a high priority. In particular, the Securities and Exchange Commission (“SEC”) and Financial Industry Regulatory Authority (“FINRA”) have signaled the importance of this issue through official and nonofficial guidance, regulatory examinations, and enforcement actions. Regulators have paid particular attention to the security of market systems, customer data protection, disclosure of material cybersecurity risks and incidents, and compliance with legal and regulatory obligations under federal and state securities laws. The SEC has enacted specific regulations guiding broker-dealer cybersecurity, while FINRA applies the SEC’s and FINRA’s supervision and reporting rules to cybersecurity. In addition, certain

states have cybersecurity regulations specific to the financial services sector.¹

Cybersecurity incidents, including breaches of customer information and ransomware attacks on broker-dealer systems, not only can cause a broker-dealer to have problems with its regulators but can cause great harm to customers whose data is affected and reputational damage to companies whose systems are impacted. Broker-dealers are prime targets for cybercriminals, since they have access to and store sensitive financial information on behalf of their customers; SEC staff recently issued an alert

¹ Much of the guidance, regulation, and enforcement activity also applies to registered investment advisers — indeed, some of the SEC actions discussed below were brought against joint registrants — but this article will largely focus on broker-dealers.

* DANIEL NATHAN is a Partner in the White Collar, Investigations, Securities Litigation & Compliance Group in the Washington D.C. office of Orrick, Herrington & Sutcliffe LLP (“Orrick”). HEATHER SUSSMAN is a Partner and COLLEEN HESPELER is an Associate in the Cyber & Privacy Advisory and Compliance Group in the Boston office of Orrick. Their e-mail addresses are dnathan@orrick.com, hsussman@orrick.com, and chespeler@orrick.com.

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