CYBERSECURITY UPDATE: NATIONAL FUTURES ASSOCIATION PROPOSES CYBERSECURITY GUIDANCE SETTING FORTH GENERAL REQUIREMENTS FOR MEMBER FIRM INFORMATION SYSTEMS SECURITY PROGRAMS

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U.S. Investment Management Alert

By: Mark C. Amorosi

The National Futures Association ("NFA") submitted to the Commodity Futures Trading Commission ("CFTC") on August 28, 2015 a proposedInterpretive Notice ("Proposed Guidance") for CFTC's approval, which provides guidance to NFA member firms on actions they should take to address cybersecurity concerns. If approved, the Proposed Guidance will affect a wide range of futures market intermediaries, including commodity pool operators ("CPOs") (including CPOs for mutual funds and other investment companies registered under the Investment Company Act of 1940), commodity trading advisors ("CTAs"), futures commission merchants, introducing brokers ("IBs"), and retail foreign exchange dealers, as well as swap dealers and major swap participants.

The Proposed Guidance sets forth a detailed series of cybersecurity recommendations for NFA member firms. The Proposed Guidance, if approved, effectively would require firms to undertake substantial cybersecurity program reviews, including risk assessments, reviewing compliance policies and procedures and incident-response protocols, and reviewing technical systems and safeguards and vendor relationships to ensure NFA member firms' practices are consistent with the Proposed Guidance. Firms should carefully review and consider the recommendations included in the Proposed Guidance, as it is likely that they will be approved (subject to changes requested by the CFTC) and will be the basis for future NFA regulatory initiatives, including on-site examinations of member firms and, potentially, disciplinary matters.

The CFTC has up to 180 days to act on the NFA's Proposed Guidance. If, as expected, the CFTC approves the proposal, the NFA will then set an effective date for the guidance, likely several months after CFTC approval. Accordingly, it is likely that the Proposed Guidance will not become effective until sometime next year.[1]

BACKGROUND

The NFA is seeking to issue the Proposed Guidance under NFA Compliance Rules 2-9, 2-36, and 2-49, which generally impose obligations on NFA member firms to diligently supervise their businesses, employees, and agents in all aspects of their commodity interest activities.

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Cybersecurity rules and interpretations traditionally have focused on the protection of personally identifiable information ("PII") provided by customers. The Proposed Guidance, however, applies not only to the protection of PII, but also to operational security matters more generally. Furthermore, while the Proposed Guidance is similar in substance to guidance provided by other regulators (see, e.g., the SEC staff's IM Guidance Update on cybersecurity), it includes numerous, more detailed recommendations regarding cybersecurity compliance expectations.

PROPOSED GUIDANCE

The major elements of the Proposed Guidance are as follows:

Written Information Systems Security Program

The Proposed Guidance states that each NFA member firm should establish and implement a written governance framework that supports informed decision-making and escalation within the firm to identify and manage information security risks. In particular, the Proposed Guidance states that:

- Each member must adopt and enforce a written information systems security program ("ISSP") reasonably designed to provide safeguards appropriate to the member's size, complexity, customers and counterparties, sensitivity of the data accessible within its systems, and its electronic interconnectivity with other entities, to protect against security threats or hazards to their technology systems.
- Each member's ISSP should be approved, in writing, by the member's chief executive officer, chief technology officer, or other executive-level official.
- Member firms' senior management should provide periodic board reports (or reports to a similar governing body, committee, or delegate) to enable the board to monitor the member's information security efforts.
- Each member should monitor and conduct an annual review of the effectiveness of their ISSPs, which review may include penetration testing of the firm's systems, and make adjustments as appropriate.

In developing an ISSP, the Proposed Guidance recommends, but does not require, that member firms use one of the many cybersecurity frameworks that have been published (e.g., the National Institute for Standards and Technology's Framework for Improving Critical Infrastructure Cybersecurity). The Proposed Guidance notes that ISSP policies and procedures may be documented in a single document or in documents maintained throughout various departments, so long as the ISSP can be made available to the NFA and the CFTC, upon appropriate request. Furthermore, the Proposed Guidance recommends firms should define the terminology used in ISSPs to facilitate their review.

Also, the Proposed Guidance recognizes NFA member firms may be part of a larger holding company structure sharing common information systems security personnel, resources, systems, and infrastructure. The top-level company in the holding company structure may be in the best position to evaluate the risks associated with the use of information technology systems, as privacy and security safeguards in these circumstances are often adopted and implemented organization-wide. Therefore, to the extent a member firm is part of a holding

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company that has adopted and implemented privacy and security safeguards organization-wide, the member firm can meet its supervisory responsibilities to address the risks associated with information systems through its participation in a consolidated entity ISSP. If a member firm is participating in a consolidated entity ISSP, the member firm will continue to have an obligation to make sure that all written policies and procedures relating to the program are appropriate to its information security risks, are maintained in a readable and accessible manner, and can be produced upon request to NFA and the CFTC.

Security and Risk Assessment

The Proposed Guidance also states that NFA member firms have supervisory obligations requiring them to assess and prioritize the risks associated with their use of information technology. According to the Proposed Guidance, the following topics should be addressed within the assessment:

- Developing and maintaining an inventory of critical information technology hardware with network connectivity, data transmission, or data storage capability, and an inventory of critical software with applicable versions;
- Identifying the significant internal and external threats and vulnerabilities to at-risk data that is collected, maintained, and disseminated (e.g., customer and counterparty PII, corporate records, and financial information);
- Assessing the threats to, and the vulnerability of, electronic infrastructure, including any systems used to initiate, authorize, record, process, and report transactions relating to customer funds, capital compliance, risk management, and trading;
- Assessing the threats posed through any applicable third-party service providers or software; and
- Identifying the devices connected to the firm's network and network structure.

Deployment of Protective Measures against Identified Threats and Vulnerabilities

The Proposed Guidance further states NFA member firms should document and describe the safeguards deployed in light of identified and prioritized threats and vulnerabilities in their ISSPs. The Proposed Guidance provides a list of example safeguards, including physical safeguards, access controls, firewalls and anti-virus and anti-malware software, software and operating system updates, software whitelists, regular backups, business continuity and disaster recovery capabilities, encryption, network segmentation, web filtering, and mobile device safeguards.

Response and Recovery from Events that Threaten the Security of the Electronic Systems

The Proposed Guidance also makes clear NFA member firms should create an incident response plan to provide a framework to manage detected security events or incidents, analyze their potential effect, and take appropriate measures to contain and mitigate such threats. Among the considerations suggested in the Proposed Guidance in developing an incident response plan are:

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- Member firms should consider in appropriate circumstances forming an incident response team responsible for investigating an incident, assessing its damage, and coordinating an internal and external response.
- Member firms should consider including in its incident response plan a description of how the member firm will address common types of potential incidents (e.g., unauthorized access, malicious code, denial of service, and inappropriate usage), including how it will communicate internally with an appropriate escalation procedure, and externally with customers/counterparties, regulators, and law enforcement. In addition, member firms should consider providing details of any detected threats to an industry-specific information-sharing platform such as FS-ISAC (https://www.fsisac.com/).
- Member firms should include procedures to restore compromised systems and data, communicate with appropriate stakeholders and regulatory authorities, and incorporate lessons learned into the ISSP.

Other Components of an ISSP

The Proposed Guidance also includes the following components that the NFA indicates should be part of a member firm's ISSP:

- **Employee Training**. The Proposed Guidance states ISSPs should contain, among other things, a description of the member firm's ongoing education and training relating to information security for all appropriate personnel.
- **Third-Party Service Providers**. The Proposed Guidance also states that ISSPs should address, as part of the security risk assessment, the risks posed by critical third-party service providers that have access to a member firm's systems; operate outsourced systems for the member; or provide cloud-based services, such as data storage or application software, to the member. The NFA is recommending member firms employ various techniques to limit the cyber risks of using third-party service providers, including performing due diligence on critical service providers' security practices; avoiding use of third parties whose security standards are not comparable to the member's standards, including in their arrangements with critical third-party service providers appropriate measures that are designed to protect customer and firm confidential data; implementing access controls on third-party service providers; and restricting or removing, on a timely basis, a third party's access to information systems once the service provider is no longer providing services.
- **Recordkeeping**. The Proposed Guidance also states that all records relating to a member firm's adoption and implementation of an ISSP and that document a member's compliance with Guidance must be maintained pursuant to NFA Compliance Rule 2-10.

CONCLUSION

The CFTC and NFA each stated earlier this year that cybersecurity would be a significant regulatory priority for each organization going forward. The Proposed Guidance appears to be a significant element of the NFA's initiatives in this area, and the content of the guidance could be the basis for future regulatory, inspection, and enforcement actions by the NFA. We expect that the Proposed Guidance (subject to any changes by the CFTC)

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will be issued soon, possibly by the end of this year. If, as expected, the Proposed Guidance is adopted, it will be important for NFA member firms to review their cybersecurity programs to ensure they are consistent with the NFA's interpretive guidance. We will keep you updated on this matter.

Notes:

[1] The NFA noted that some member firms already have cybersecurity programs in place, while others will need to devote significant time and resources to meet their obligations. Therefore, the NFA recognizes that it may need to provide additional, more detailed guidance to smaller IBs, CPOs, and CTAs so these firms may satisfy their obligations. Given that this guidance would impose significant new obligations, the NFA stated that it intends to develop an incremental, risk-based examination approach regarding the Interpretive Notice's requirements, and has indicated that it will initially work with member firms to assist them in developing their programs.

KEY CONTACTS



MARK C. AMOROSI
CO-LEAD PRACTICE AREA LEADER -
ASSET MANAGEMENT AND INVESTMENT
FUNDS

WASHINGTON, DC
+1.202.778.9351
MARK.AMOROSI@KLGATES.COM

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