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Broker and Compliance Officer of Broker-Dealer Firm Personally Fined by SEC for Customer Privacy Violations

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On April 7, 2011, the SEC announced that it had imposed fines of $20,000 each against the former president of a broker-dealer and a former broker for their actions in transferring customer information to a new firm as the defunct firm wound down. The SEC also fined the brokerage firm's former chief compliance officer $15,000 for compliance failures and security breaches that took place at the defunct firm, some dating back to 2005.

Broker-dealers should take careful note of this latest enforcement of Regulation S-P, the "Safeguards" Rule. The SEC's action highlights, among other things, the requirement for broker-dealers to have policies and procedures reasonably designed to safeguard customer confidential information. The SEC's action also communicates that a broker-dealer's compliance officer will be viewed by the SEC to be personally responsible for failures in meeting this requirement.

The SEC charged that the president of the firm authorized a departing broker to take information from more than 16,000 accounts from the firm as it was winding down and transfer it to a new firm, without providing notice to the customers and a prior opportunity to opt out. The confidential information, which included customer names, addresses, account numbers and asset values, were transferred on a portable drive by the departing broker and then provided to the new firm.

In assessing a fine against the firm's former compliance officer, the SEC pointed to a series of security breaches at the former firm, including the theft of laptop computers and unlawful access to its e-mail system by a former employee using stolen passwords. The SEC charged that the compliance officer took no action to revise or supplement the firm's policies and procedures following these breaches.

The defunct firm's policies and procedures themselves were deficient, the SEC alleged, because they were vague and "did little more than recite a provision" of the Safeguards Rule. Among other things, the firm's policy on safeguarding information was less than a page long, did not specify any procedures that the firm had adopted, failed to instruct employees on how to safeguard customer information, contained no provisions concerning follow-up procedures in the event of a security breach, and failed to specify a firm principal responsible for monitoring and testing security procedures and identifying reasonably foreseeable risks.

SEC Regulation S-P, promulgated pursuant to the Gramm-Leach-Bliley Act, applies to investment companies regulated under the Investment Company Act of 1940. Regulation S-P requires such broker-dealers to adopt written policies and procedures that address administrative, technical, and physical safeguards for the protection of customer records and information, and that are reasonably designed to: (1) insure the security and confidentiality of customer records and information; (2) protect against any anticipated threats or hazards to the security or integrity of customer records and information; and (3) protect against unauthorized access to or use of customer records or information that could result in substantial harm or inconvenience to any customer

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- **Jeffrey D. Neuburger**
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